MT LEGISLATIVE HISTORY

Chapter 554 1983

Bill H 685 S _____ Original bill & hist. ✓ C

H. Committee on Select Econ. Dev. S. Committee on Bus' Ind

Hearing Date(s)	C	Hearing Date(s)	C
2/10	✓ C	3/10	✓ C
_____	C	_____	C
_____	C	_____	C
Date Out 2/20	✓ C	3/22	✓ C

Did this bill originate in an interim committee? ___ Yes X No

Committee _____ Report _____

HOUSE BILL NO. 685

INTRODUCED BY HARPER, VAN VALKENBURG, TOWE, VINCENT, FABREGA, CRIPPEN, KEMMIS

BY REQUEST OF THE GOVERNOR'S OFFICE

IN THE HOUSE

February 8, 1983	Introduced and referred to Select Committee on Economic Development.
February 21, 1983	Committee recommend bill do pass as amended. Report adopted.
	Statement of Intent attached.
February 22, 1983	Bill printed and placed on members' desks.
February 23, 1983	Second reading, do pass.
	Considered correctly engrossed.
	Third reading, passed. Transmitted to Senate.

IN THE SENATE

March 1, 1983	Introduced and referred to Committee on Business and Industry.
March 23, 1983	Committee recommend bill be concurred in as amended. Report adopted.
March 25, 1983	Second reading, pass consideration.
March 26, 1983	Second reading, concurred in.
March 28, 1983	Third reading, concurred in. Ayes, 45; Noes, 2.

IN THE HOUSE

March 28, 1983	Returned to House with amendments.
April 1, 1983	Second reading, amendments concurred in.
April 4, 1983	Third reading, amendments concurred in.
	Sent to enrolling.
	Reported correctly enrolled.

LC 0320/01

House BILL NO. 685

INTRODUCED BY Harper Vanvalkenburg Gus Vincent Zabrocki

BY REQUEST OF THE GOVERNOR'S OFFICE Kennard Oppedahl

A BILL FOR AN ACT ENTITLED: "AN ACT PROMOTING THE AVAILABILITY AND INVESTMENT OF DEVELOPMENT CAPITAL IN MONTANA THROUGH THE CREATION OF CAPITAL COMPANIES; PROVIDING TAX CREDITS FOR INVESTMENT IN THE COMPANIES; PROVIDING OVERSIGHT AND AUDITING REQUIREMENTS; PROVIDING THAT OFFERINGS OF THE COMPANIES ARE EXEMPT FROM SECURITIES REGISTRATION; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Short title. [This act] may be cited as the "Montana Capital Company Act".

Section 2. Declaration of policy. (1) The legislature finds and declares that:

(a) economic insecurity due to unemployment is a serious menace to the health, safety, and general welfare of not only the affected people but of the people of the entire state;

(b) involuntary unemployment, with its resulting burden of indigency, falls with crushing force upon unemployed workers and ultimately on the state itself in the form of public assistance and unemployment compensation payments; and

(c) unemployment causes a migration of Montana workers and families seeking jobs and establishing homes elsewhere, which deprives the state of its most valuable resource, its people, and reduces the tax base of local governments, impairing their ability to provide basic services.

(2) (a) The legislature further finds that the best method of combating unemployment and protecting Montana against the loss of its people is by promoting, stimulating, developing, rehabilitating, and revitalizing the business prosperity and economic welfare of the state and its citizens.

(b) To accomplish this goal, the legislature seeks to encourage the formation of venture and equity capital in Montana for use in diversifying, strengthening, and stabilizing the Montana economy by increasing Montana employment and business opportunities while protecting the peoples' constitutional right to a clean and healthful environment.

(3) The legislature further finds that:

(a) private investment of venture and equity capital in the Montana economy will be encouraged and promoted by making tax credits available to taxpayers investing in Montana businesses;

(b) demands on state revenues restrict the financial

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ability of the state to make unlimited tax credits available for investment purposes and require that the state place reasonable limits on the total amount of tax credits to be made available for investment incentive;

(c) establishment of a rational tax credit program which gives priority to investments in the order of time in which they are committed will encourage prompt private investment in Montana businesses.

Section 3. Purpose. (1) The purpose of [this act] is to promote the development of the human resources and the diversification of the economy of Montana. The venture capital generated by [this act] must be used to encourage and assist the strengthening of the economy through loans, equity investments, and other business transactions for purposes of developing new small business and industry in Montana, rehabilitating existing small business and industry, and stimulating and assisting in the expansion of small business activities that promote and maintain the economic stability of the state by providing maximum opportunities for employment and imoroving the standard of living of the people of Montana.

(2) [This act] is aimed at:

(a) increasing the availability of development capital in order to encourage and assist in the creation, development, and expansion of small businesses based in

Montana and controlled or managed by residents of Montana;

(b) aiding those businesses to which risk and equity financing are not readily or fully available through traditional sources;

(c) developing, preserving, diversifying, expanding, and strengthening the agricultural, industrial, and business base of Montana's economy, particularly for those small businesses utilizing the state's technical, managerial, and research resources in domestic and international markets; and

(d) providing the residents of Montana with greater opportunities to invest and participate in the economic development and potential of the state.

Section 4. Definitions. As used in [this act], unless the context requires otherwise, the following definitions apply:

(1) "Capital base" means equity capital or net worth.

(2) "Certified Montana capital company" means:

(a) a development credit corporation created pursuant to Title 32, chapter 4; or

(b) a profit or nonprofit entity organized and existing under the laws of Montana, created for the purpose of making venture or risk capital available for qualified investments and that has been certified by the department.

(3) "Department" means the department of commerce

provided for in Title 2, chapter 15, part 18.

(4) "Montana business" means a business which is located or principally based within Montana.

(5) "Qualified investment" means a debt or equity financing of or a purchase and leaseback financing of a Montana business that meets both of the following criteria:

(a) the business is engaged in one or more of the following activities:

(i) manufacturing;

(ii) agricultural, fishery, or forestry production and processing;

(iii) mineral production and processing, except for conventional oil and gas exploration;

(iv) recognized nonfossil forms of energy generation as defined in 15-32-102(5);

(v) transportation;

(vi) research and development of products or processes associated with any of the activities enumerated in (i) through (v) above;

(vii) wholesale or retail distribution activities for which products produced in Montana comprise 50% or more of the gross sales receipts; and

(viii) any activity conducted in the state for which 50% or more of the gross receipts are derived from the sale of products or services outside Montana; and

(b) the business is a small business as defined in rules adopted by the department.

(6) "Qualified Montana capital company" means a certified Montana capital company that has been designated a qualified capital company under the provisions of [section 6] so that investors in the company may receive the tax credits authorized in [section 6].

Section 5. Certification of Montana capital companies. (1) Every 6 months, commencing March 1, 1984, or 3 months after rules are adopted to implement [this act], whichever occurs first, the department shall certify Montana capital companies. A company seeking to be certified as a Montana capital company must make written application to the department on forms provided by the department. The application must contain the information required by [section 16] and such other information as the department requires. The application and certificate must specify the level of capitalization that the company expects to qualify for the tax credits provided for in [section 6].

(2) The application must show that the applicant's purpose is to encourage and assist in the creation, development, and expansion of Montana-based businesses and to provide maximum opportunities for the employment of Montanans by making venture capital available to sound small Montana firms.

(3) Certifiable applicants include but are not limited to local and community development corporations, small business administration 503 corporations, and small business investment companies.

(4) Certification is a prerequisite to and must be completed before seeking designation as a qualified capital company.

Section 6. Designation of qualified Montana capital companies -- tax credit. (1) Every 6 months, commencing 6 months after the first date on which the department certifies a Montana capital company, the department shall designate as qualified Montana capital companies those certified companies that have been privately capitalized at a minimum level of $200,000. A certified company seeking designation as a qualified Montana capital company must make written application to the department on forms provided by the department. The application must contain the information required by [section 16] and such other information as the department requires. The application must be accompanied by a bond sufficient to cover the cost of any penalty that could be assessed under [section 7(4)].

(2) The total amount of tax credits authorized for a single qualified company may not exceed the company's private capitalization or $375,000, whichever is less. In the event the capitalization of the company is later

increased, the company may apply for authorization of additional tax credits within the foregoing limitation. The total credits authorized for all companies may not exceed a total of $1 million prior to June 30, 1985. The total credits authorized for all companies between July 1, 1985, and June 30, 1987, may not exceed $1 million plus any portion of the $1 million available for authorization before June 30, 1985, that is allocated to qualified companies. The credits shall be allocated to qualified companies in the order that completed applications for designation as qualified capital companies are received by the department, and the department shall certify to each such company its appropriate allocation.

(3) Investors in a qualified Montana capital company are entitled to the tax credits provided for in subsection (4). Funds invested in a certified company prior to designation as a qualified Montana capital company may, at the discretion of the investor, be placed in an escrow account in a Montana financial institution pending designation of the company as a qualified Montana capital company.

(4) Subject to the provisions of subsection (2), an individual, small business corporation, partnership, or corporate taxpayer who makes a capital investment in a qualified Montana capital company is entitled to a tax

credit equal to 25% of the investment, up to a maximum credit of $25,000 per taxpayer. The credit may be taken against the tax liability imposed on the investor pursuant to Title 15, chapter 30 or 31. The credit for investments by a small business corporation electing to be taxed under 15-31-202 or a partnership may be claimed by the small business corporation shareholders or the partners.

(5) The tax credit allowed under subsection (4) is to be credited against the taxpayer's income tax liability for the taxable year in which the investment in a qualified Montana capital company is made. If the amount of the tax credit exceeds the taxpayer's tax liability for the taxable year, the amount of the credit which exceeds the tax liability may be carried back or carried forward in accordance with the provisions of section 46(b) of the Internal Revenue Code of 1954, as amended.

(6) The tax credit provided for in this section is available only to those taxpayers who invest in a qualified Montana capital company within 5 years of [the effective date of this act].

Section 7. Unused investments -- company penalty. (1) If the amount invested by a taxpayer in a qualified Montana capital company is not used by the company for qualified investments as provided in subsection (2), the taxpayer is not subject to a recapture provision for any tax credit

claimed by him but the company is subject to the penalty provided for in subsection (4).

(2) A qualified Montana capital company receiving investments for which a taxpayer has applied and received a tax credit must use its capital base to make qualified investments according to the following schedule:

(a) at least 30% of its capital base within 3 years of the date on which tax credits were certified as allocated to the company for investment;

(b) at least 50% of its capital base within 4 years of the date on which tax credits were certified as allocated to the company for investment; and

(c) at least 70% of its capital base within 5 years of the date on which tax credits were certified as allocated to the company for investment.

(3) Following each annual examination, the commissioner of financial institutions shall notify the department of revenue of any companies that are not in compliance with this section.

(4) A qualified Montana capital company that fails to make qualified investments pursuant to subsection (2) shall pay to the department of revenue a penalty equal to all of the tax credits allowed to the taxpayers investing in that company during that time period, with interest at 1% a month from the date the tax credits were certified as allocated to

the qualified Montana capital company. The department of revenue shall deposit any amount received under this subsection to the credit of the state general fund.

Section 8. Investment reporting and recordkeeping. (1) Each qualified Montana capital company shall report to the department on a quarterly basis:

(a) the name of each investor in the qualified Montana capital company who has applied for a tax credit;

(b) the amount of each investor's investment; and

(c) the amount of the tax credit allowed to the investor and the date on which the investment was made.

(2) The department shall provide the information contained in subsection (1) to the department of revenue on a quarterly basis.

(3) The department shall provide each investor in a qualified Montana capital company with a certificate authorizing the tax credit, and the certificate shall be submitted with each tax return requesting a credit under [section 6].

(4) Each qualified Montana capital company shall report to the department on a quarterly basis all qualified investments that the company has made. The department shall share the information with the department of revenue, in order that the provisions of [section 7] may be complied with.

Section 9. Restriction on investment. No more than 50% of the capital base of a Montana capital company may be invested in any one Montana business, and no more than 25% of the total funds raised for which tax credits were claimed pursuant to the investment credit provisions of [this act] may be invested in any one Montana business.

Section 10. Conflict of interest. (1) The director of the department, the commissioner of financial institutions, or a bank examiner may not have a monetary interest in or be a borrower from any Montana capital company, either directly or indirectly.

(2) A member of the investment committee of a Montana capital company who has an interest in a venture that comes before the committee for a vote shall disclose such interest and abstain from voting on investment in the venture.

Section 11. Legislative review and oversight. The department shall report on an annual basis to the revenue oversight committee of the legislature concerning Montana capital companies.

Section 12. Examination. (1) At least once a year the bank examiners of the department of commerce shall examine the books and affairs of each Montana capital company. The examination must address the methods of operation and conduct of the business of the Montana capital company to determine if the company is abiding by the purposes of [this

act] and that the funds received by the company have been invested within the time limits required for a qualified Montana capital company in [section 7].

(2) The department of commerce may examine under oath any of the officers, directors, agents, employees, or investors of a Montana capital company regarding the affairs and business of the company. The department of commerce may issue subpoenas and administer oaths. Refusal to obey such a subpoena may at once be reported to the district court of the district in which the company is located, and the court shall enforce obedience to the subpoena in the manner provided by law.

(3) The cost of the annual review must be paid by each Montana capital company in accordance with reasonable fees assessed by the department.

Section 13. Decertification. (1) If the examination conducted pursuant to [section 12] discloses that a Montana capital company is not in compliance with the provisions of [this act], the department of commerce may exercise any of the powers with regard to banks granted in Title 32, chapter 1, part 5, and may seize the assets of the company and liquidate it.

(2) If in the discretion of the department of commerce the action allowed under subsection (1) is not required to protect the company's investors, the department of commerce

may place the company on notice that it will lose its certification as a Montana capital company within a specified period of time if the company does not come into compliance with the provisions of [this act].

(3) As long as the department acts in good faith, the department and its employees and agents may not be held civilly or criminally liable or liable upon their official bonds for action taken under this section or for any failure to act under it.

Section 14. Application of securities law. In lieu of registration under Title 30, chapter 10, a Montana capital company may file all disclosure documents, along with a consent to service of process, with the state securities commissioner. The commissioner may not charge a fee for such filing or deposit.

Section 15. State liability disclaimed. The state of Montana may not be held liable for any damages to an investor in a Montana capital company that fails to become designated as a certified or qualified Montana capital company.

Section 16. Application requirements. A company applying to become either a certified or qualified Montana capital company shall include in its application evidence that it has disclosed or will disclose to all investors the following:

(1) the condition that a tax credit is not available for investment in a company until the company has been designated a qualified Montana capital company and the investor has received a certificate approving the credit from the department;

(2) the terms and conditions under which a company may be denied designation as a qualified Montana capital company and the limits on tax credits that may be authorized; and

(3) the fact that the state of Montana is not liable for damages in accordance with [section 15].

Section 17. Rulemaking. The department may adopt rules to implement the provisions of [this act].

Section 18. Coordination. (1) If either House Bill No. 100 or ____ Bill No. ____ [LC 1148], including the sections of those bills creating the Montana economic development board, is passed and approved, all references to "the department of commerce" in sections 4 through 11 of this act are changed to "the Montana economic development board".

(2) If section 17 of House Bill No. 100 is passed and approved, "the committee" referred to in section 11 of this act is changed to "the economic development oversight committee".

Section 19. Severability. If a part of this act is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of this act is invalid in

one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

Section 20. Effective date. This act is effective on passage and approval.

-End-

STATUS SHEET

ECONOMIC DEVELOPMENT COMMITTEE

Legislature

ll No.	Subject Matter	Date In	Sponsor	Hearing Date	Committee Action	Date Out
B 100	An act to implement section 3 or initiative 95; creating an in-state investment fund to be administered by the Montana Economic Devel. Bd.	1/25/83	Kemmis, Towe Vincent	2/3/83	Do Pass, as amended	2/20/83
B 125	An act to delete "Credit" from Development Credit Corporations in Montana...and provide an immediate effective date.	1/29/83	Blaylock, Mazurek, Himsl	Referred to	House Business & Industry Com.	
HB 685	An Act promoting the availability and investment of devel. capital in Mont. through the creation of capital comp; providing tax credits and investment in the comp.	2/08/83	Harper	2/10/83	Do Pass, as amended	2/20/83
HB 700	An act creating the Mont. Econ. Develop. Board: providing for the powers, duties, and composition of the board; providing authority to issue bonds to finance design. projects.	2/12/83	Fabrega	2/15/83	Do Pass, as amended	2/20/83
HB 721	An act to create a Montana Health facility auth. with power to lend money to health instit. to construct or renovate heath fac; and empowering auth to issue bonds to finance its projects	2/14/83	Wallin	2/17/83	Do Pass, as amended	2/21/83
HB 818	An act to auth. the issuance and sale of gen. oblig. bonds of the state of Mont.	2/15/83	Bengtson	2/17/83	Do Pass as amended	2/20/83

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MINUTES OF THE SELECT
COMMITTEE ON ECONOMIC DEVELOPMENT

The fourth meeting of the Select Committee on Economic Development was called to order by Chairman John Vincent at 8:45 p.m. in the old Supreme Court hearing room of the Capitol Building, Helena, Montana on February 10, 1983.

Roll call was taken and all members were present with the exception of Representative Harrington who was excused.

CHAIRMAN VINCENT opened the hearing on House Bill 685.

REPRESENTATIVE HARPER, Chief Sponsor of HB 685, stated this was a good bill and it fills a vital gap and a big nitch in the program to develop Montana's economy. It addresses the need for risk capital to start new businesses and expand existing ones. Statistics show that one out of five businesses fail, so we are not talking about state money or coal tax money, we are talking about private money. This bill adresses how to attract this private money into venture capital pools. The venture capital field is a changing dynamic field that is growing in the United States today. He noted this bill is along the same lines as Representative Fabrega SPIC Bill from last session which ended up being killed in the Senate. The need has been seen for years, and it is finally being addressed by this bill. HB 685 will provide $1 million per biennium in tax credits to attract this pool of venture capital and aid in the formation of capital companies which can be certified and designated by the department. Each one of these will receive a maximum of $375,000 tax credit, and credit can equal 25% of the investment up to a maximum of $25,000 per taxpayer. An added feature of this is, since venture capital investments usually have strong equity features, we have a real link going on between the older experienced business heads and a sharing of experience with the people that they are investing some of their money in. This should be a real benefit and provide some of the needed money.

SENATOR VAN VALKENBURG, Co-Sponsor of HB 685, asked permission from Chairman Vincent to go through the mechanics of HB 685. He passed out Exhibit A, the Statement of Intent, to the committee.

CHAIRMAN VINCENT asked for Proponents to HB 685.

PROPONENTS

GARY BUCHANAN, Director of Department of Commerce, stated his support of HB 685. He explained Exhibit B, the flowchart of Montana Capital Companies Tax Credits, and Exhibit C, Investing in America.

JOHN MARCHI, Vice-President of D.A. Davidson, expressed support of HB 685 and felt this was the most important Bill developed from the Governor's Temporary Committee concerning I-95. He emphasized what he felt to be the key points concerning this bill. See Exhibit D and Exhibit E.

DICK REMINGTON, Montana Vice-President of Mountain Bell, and representing Montana Development Credit Corporation, expressed support of HB 685. He stated this was a well designed and thoughtful approach to providing incentives for the private sector to meet the risk and equity capital needs of Montana's small business community. He stated there exists a strong consensus among Montana's financial and business community that we lack access to venture capital, and that this is likely the most serious capital problem facing our small business people. See Exhibit F.

JOHN SCULLY, Representing Montana Independent Bankers Association, expressed their support of HB 685.

FRED FLANDERS, Representing Northwestern Bank of Helena, stated their support of HB 685. He noted that from a bankers point of view, the type of capital talked about is a type of capital not available through conventional banking sources. We offer debt capital and this type of capital can very much facilitate the borrowing of the former group. We strongly feel this is an area that is desperately needed in Montana and urge the committee to pass this legislation.

MIKE FITZGERALD, Representing the Montana Trade Commission, expressed support of this bill. He stated he had worked on the committee three years ago and worked on efforts to gear up the DCCM and also supported Representative Fabrega's bill in the last session. Venture capital is the life blood of the new business, and is virtually the only vehicle that we can potentially develop in Montana in the near term. He asked the Committee to view his Exhibit G, which is the 1982 Venture Capital Directory. He drew attention to the last page which lists the 10 largest independent venture capital firms. These 10 firms were contacted about three years ago to see if they would invest in Montana and virtually everyone of these firms stated they would consider investment potential in Montana and outlined the categories they were potentially interested in. Virtually everyone of them said they would not invest in Montana until such time as there was an institution here they could work with to package, structure and help manage their investments. We see this Montana Capital Corporation as that vehicle, and feel this is very important not only as to the level we are speaking of here, but to access much larger levels of capital here in Montana for investment purposes.

DICK BOURKE, Vice-President of the Development Credit Corporation of Montana, stated his corporation enthusiastically endorses the approach to solving our risk and equity capital

problems contained in HB 685. He wanted to mention a few of the safeguards contained in the bill to insure that its objectives are met as efficiently as possible. See Exhibit H. He also wanted to bring to the attention of the committee several proposed amendments to HB 685, see Exhibit H, pages 3, 4, 5, 6, 7 and 8.

CASEY EMERSON, President and General Manager of King Tool in Bozeman, stated support of HB 685. He stated his company manufactures small specialty hand tools that are sold nation-wide. They presently employ 11 people and are now a nice profitable company, but went through some real struggles and still have a long way to go. He gave a case history to emphasize the financial problems that manufacturers have in Montana. He noted because of the present financing problems, he has placed an add in the Wall Street Journal to sell the company if the current problems can't be solved. One of the apparent problems is that they are way behind in scheduling and production and are behind at least 2 years because of the lack of financing. Had the bills that are being worked on now, been passed two years ago, Montana's government would have gained about $51,000 in corporate tax, about $40,000 in income tax during the last two years, and that is just from this one small company. He commented that when the manufacturers in Bozeman get together, the most discussed topic is horror stories about the lack of financing. He stated the committee would be acting on about three different bills, and all three of these bills are needed because manufacturers have different problems, and different aims. He feels of all the bills coming up, HB 685, is the most badly needed one of all, and if passed will help keep his company here in Montana.

JANELLE K. FALLAN, Public Affairs Manager of Montana Chamber of Commerce, stated their support of HB 685. She noted the Private Industry Council, in which the Montana Chamber was actively involved contracted for a study that determined there is definitely a need for such capital in Montana. Her further remarks are seen in Exhibit I.

DON JUDGE, Representative of Montana State AFL-CIO, expressed support of HB 685. He noted that even though this bill contains no provisions for matching money from the state, as originally proposed, he believes that this legislature still has some ownership over the "targeting" of "qualified" investments because of the tax credit provisions. Because these provisions reflect a credit for liability of money owed the state, it is his assumption that state money is still involved here. He stated assuming that the legislature still has the ability to provide "targeting" goals for "qualified" investments, he would like to suggest a few amendments. See Exhibit J, pages 1, 2 and 3.

JOHN LOPACH, Director of the Economic Growth Council of Great Falls, expressed support of HB 685. He feels this is probably the most important bill before the committee. He explained without non-debt borrowing base equity, companies simply cannot expand, or even attract suppliers. He stated that the Economic Growth Council has loaned companies the money needed to expand only to find that the debt that has been put on the books make it difficult for them to buy on credit from suppliers, because their debt ratios are too high. Equity capital is an answer to this problem. He stated he would like to make a few suggestions. One is to consider the concept in place of the network of Montana Capital Companies, the use of the federal Small Business Investment Companies. These SBIC's were organized by the Small Business Investment Act in 1958 and have been regulated by the federal government very successfully. They include many of the most powerful venture capital companies in the U.S., and they have the tremendous advantage of borrowing four times the capital from the federal government at treasury note rates. The regulation of the Small Business Investment Companies is by the Investment Division of the SBA. SBIC also have the tremendous asset of a network with other SBIC's with whom they can syndicate their investments. He also wanted the Committee to look carefully at the minimum capital suggested in the bill which is $200,000 and at the concept of allowing half of that going into any one investment. He noted that by making this testimony he does not want to upset anything, but to be able to come back in 2 years and answer the question, "Did we act wisely?" in setting up the most important bill before us. He also asked the committee to look again at the maximum credit of $25,000 per investor which he considers too low. He expressed hope that this bill comes out as one of the strongest in this session.

JACK MARTIN, President and General Manager of Superior Fire Aparatus, stated his support of this bill. He commented that during a recent meeting of a group of manufacturers, he was nominated the spokesperson. He stated that HB 685 contributes to a broader tax base, greater employment and in time will help lessen the ever increasing tax burden on those who presently have businesses already established.

DAN BUCKS, Department of Revenue, stated he would like to make two types of comments. First a general comment relating to a conclusion his department has arrived at, is that tax credits that are highly targeted for specific purposes are more effective in accomplishing their ends than tax credits that are too general. Secondly in respect to the features of this bill that have been commented on by other proponents, he would like to explain the reasons why they were written the way they were. See Exhibit J-1 for further information.

DON REED, Representing the Montana Environmental Information Center, stated their support of HB 685. He feels that HB 685 is different from some of the other bills because it does not directly invest any state held funds, but rather it uses tax credits to stimulate private investment. He noted he would like to make a few suggestions regarding the Economic Development Board. See Exhibit K for further comments.

CAROL DALY, President of the Montana Economic Development Association, stated their support of HB 685. She stated that MEDA believes that the Capital Companies bill should be passed for two reasons. The first would be that it would help fill a gap in financing resources in the state, and secondly it represents a positive private sector response to a private sector problem, and facilitates the investment of Montana capital in Montana. For further comments see Exhibit L.

SENATOR TOWE, explained to the committee that this is the Venture Capital portion. It is true that a qualified investment may well be debt as well as lease-hold, but the principal focus is on the equity venture capital, and that is very important as the other proponents have pointed out. The second important fact about this bill is that it is the private industry that is doing this. He stressed you can't get the private sector to make the investment without giving them an incentive. He noted they had hoped for a larger incentive, but this would be a start and it can be expanded from there. He agreed with John Lopach's testimony regarding the advantages of the SBIC. He noted that we will first have to see how well this is being utilized and may eventually have to open this up to more than Montana Venture Capital Corporations. He commented that it may be that no corporation in Montana can attract the type of talent that will make this work, and we should not be discouraged by this. He stressed this is a very important piece of legislation and is needed to support the other bills currently being put before the committee.

STACY A. FLAHERTY, Representing Women's Lobbyist Fund, stated their support of HB 685. They particularly feel this bill is important because it will make credit available for businesses owned and operated by women. They would like to recommend adding to the aims of this bill the attached suggestions. See Exhibit M.

RON HARMON, President of Big Bud Tractor Company in Havre stated his support of HB 685. He noted that his company went from 200 employees down to 40 due to lack of capital. During the past few months, he has been to Chicago, Kansas City and New York looking for capital. One of the things admitted by

the venture capital people when he visited them is that he would be paying a premium to bring capital into his company. He asked the question why he should have to pay a premium for capital just because he decided to locate in Montana. He feels this is a very important bill and he looks forward to its implementation.

KEN MACMAN, Billings manufacturer, stated he feels this is the greatest bill, because venture capital so far in this state is nonexistent. He felt one thing brought up that is a good idea was regarding the $200,000 capitalization. He feels there should not be a figure placed on this, but the individual company should be judged on their individual program. He agreed with changing the date to September 1983 since the sooner this gets going, the sooner businesses will be paying taxes. Secondly he feels they should raise the $375,000 figure. He agreed it is important not to re-invent the wheel and the best way to get ahead is to steal someone else's idea. He stated we should pay more attention to our neighbor to the east, since they rank number 4 in the nation business wise, and Montana ranks number 28. He expressed hope for the passage of HB 685, since it will help put people to work.

ROBERT M. GRIFFIN, Liberty Manufacturing in Chester, stated support for HB 685. He agreed with previous testimony regarding the frustration of expansion and the necessity of expanding with equity capital. The high interest rates available through the banks have caused problems in his business, and he is presently in a reorganization process. He feels had there been venture capital available 2 years ago, he would not be in his present position. If Montana is going to get ahead in their economic development, there has to be some means where people can attain venture or equity capital.

CHAIRMAN VINCENT asked if there were any OPPONENTS to HB 685. There being no OPPONENTS to the bill, he asked for questions from the committee. There being no questions from the Committee, the hearing on HB 685 was closed. The committee went into Executive Session.

EXECUTIVE SESSION

REPRESENTATIVE FAGG moved to approve the bill drafting request for a committee bill to expand or supplement the umbrella bonding bill. See Exhibit N. The motion carried unanimously.

REPRESENTATIVE FABREGA stated there was a meeting of a number of people who were interested in HB 70 regarding its subject matter. At the recommendation of the committee, HB 70 was tabled. He would like to make a request for bill

drafting authority on three separate bills, rather than have them all in one. They would be called revenue bills even though they do not effect revenue at the current level. The purpose of the first bill would be to provide an incentive to encourage energy conservation quality for use in the state for export. The second bill would encourage and manufacture energy efficient wood stoves in regard to minimum air pollutants. The third bill would offer tax incentives to encourage in-state manufacturers on renewable energy equipment.

REPRESENTATIVE FABREGA moved the Committee authorize the drafting of these three bills. The motion carried unanimously.

REPRESENTATIVE FABREGA moved that HB 70 BE TABLED. The motion carried unanimously.

CHAIRMAN VINCENT stated the last item of business tonight was consideration of another committee bill relative to the submission of the Constitutional Amendment No. 10, See Exhibit O.

REPRESENTATIVE METCALF moved to have a committee bill to draft the Constitutional Amendment No. 10. The motion carried unanimously.

The Executive Session adjourned at 10:42.

Mitzie Grover
Secretary

Representative John Vincent
Chairman

STATEMENT OF INTENT

HOUSE BILL 685

A Statement of Intent is required for House Bill 685 because it grants rulemaking authority to the Department of Commerce to implement the act.

It is the intention of the legislature that the tax credits herein provided be applied only in the case of properly qualified investments. It is therefore the intention of the legislature that the department of Commerce, in making rules to define a small business, use whatever means necessary to arrive at a definition of small business which takes into account the unique nature of Montana small business. It is similarly the intention of the legislature that in the development of rules for certification and qualification of capital companies, the department shall take into account the capital needs of the state based upon such information made available to it on its own initiative and through such hearings as are necessary to achieve the purposes of the act. It is further the intention of the legislature that in determining such rules as are necessary to carry out the examination functions of the act, the department shall take into account commonly accepted principals of financial institution examinations currently

in use in the examination of banks and other such institutions. It is further the intention of the legislature that the rules authorized in the act be adopted in a timely fashion.

-END-

STATE OF MONTANA

REQUEST NO. 366-83

FISCAL NOTE

Form BD-15

In compliance with a written request received February 10, , 19 83 , there is hereby submitted a Fiscal Note for House Bill 685 pursuant to Title 5, Chapter 4, Part 2 of the Montana Code Annotated (MCA). Background information used in developing this Fiscal Note is available from the Office of Budget and Program Planning, to members of the Legislature upon request.

DESCRIPTION OF PROPOSED LEGISLATION:

House Bill 685 authorizes the creation of Montana capital companies, their certification by the Department of Commerce and a total of $1,000,000 in tax credits against personal or corporate income tax for each of the next two bienniums for investors in the "qualified" capital companies. Qualified capital companies must have a minimum of $200,000 capitalization and tax credits are limited to $25,000 per investor. The act provides for the annual examination of the companies by the commissioner of financial institutions and repayment of tax credits and penalties by a capital company that fails to make qualified investments as authorized by the act. The act will be administered by the Department of Commerce or the Montana Economic Development Board if House Bill 100 is adopted.

ASSUMPTIONS:

1) Ten companies with $400,000 capital base each will be certified and authorized by the end of the biennium so that the entire $1,000,000 in tax credits will be used.
2) Assume that the tax credits will be taken in FY 1985, although they can be carried both forward five years and back three years.
3) Companies will not begin actual operations until second year of biennium.
4) Company with $400,000 in capital base could leverage another $1,600,000 in investments.
5) Examination of companies will be somewhat simpler than examination of depository financial institutions and will take only 1/2 of the examination man-days to examine and produce a report that it would take for a depository institution of the same size.
6) Staff work for certification, qualification, adoption of rules, examination, and granting tax credits can be done by existing staff of the Department of Commerce and Revenue.

FISCAL IMPACT:

	FY84	FY85
General Fund		
Reduction Due to Credit	$ -0-	$ (750,000)
Exam Fees Deposited	-0-	11,000
Net Decrease	$ -0-	$ (739,000)
School Foundation Program		
Reduction Due to Credit	$ -0-	$ (250,000)
Expenditures:		
Adopt rules, printing, etc.	$ 3,700	$ -0-
Examination process	11,000	11,000
Total	$11,000	$ 15,700

David M. Lewis

BUDGET DIRECTOR

Office of Budget and Program Planning

Date: 2-15-83

FISCAL NOTE 13:P:1

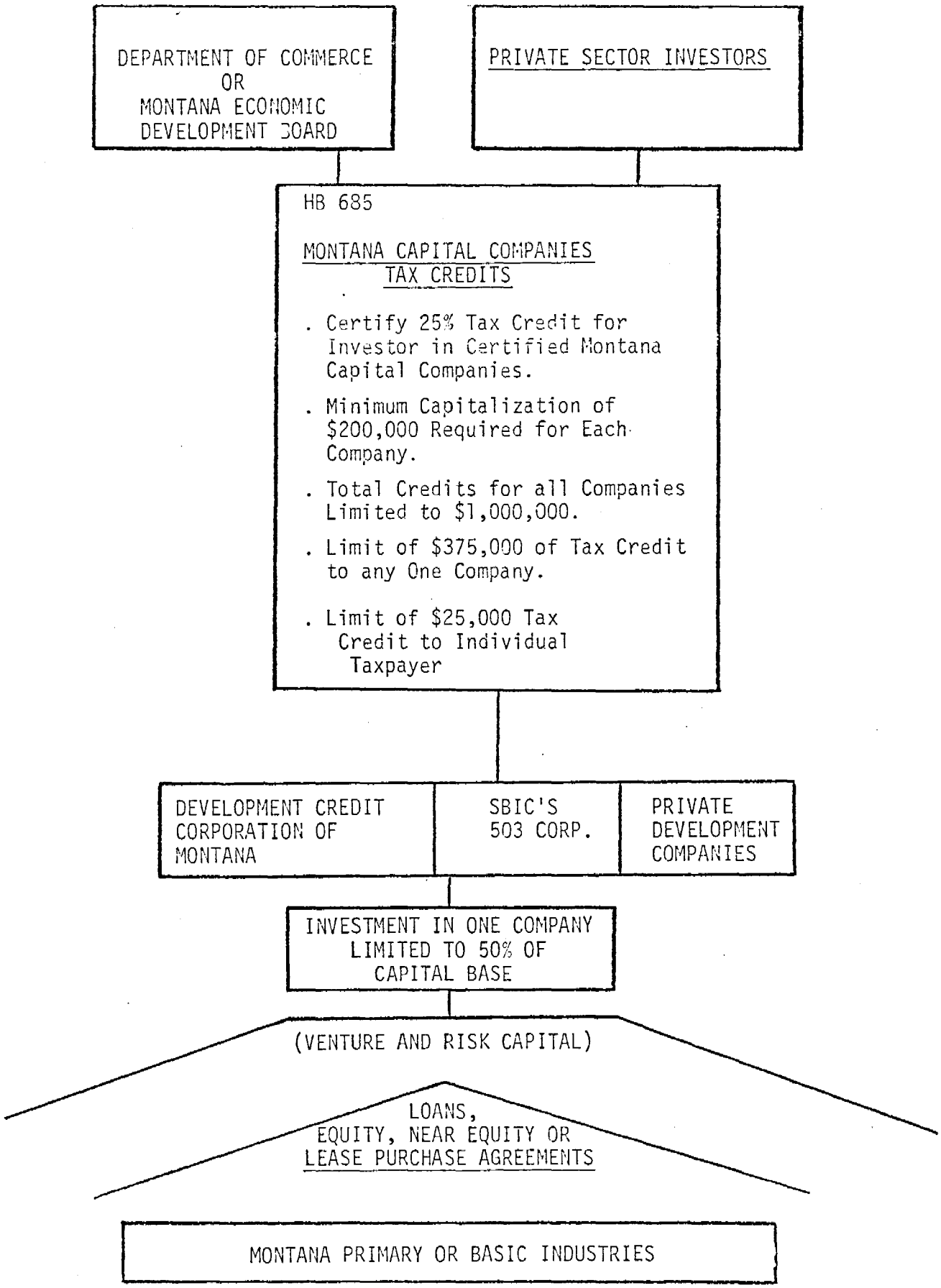

DEPARTMENT OF COMMERCE
OR
MONTANA ECONOMIC
DEVELOPMENT BOARD
PRIVATE SECTOR INVESTORS
HB 685
MONTANA CAPITAL COMPANIES
TAX CREDITS
. Certify 25% Tax Credit for Investor in Certified Montana Capital Companies.
. Minimum Capitalization of $200,000 Required for Each Company.
. Total Credits for all Companies Limited to $1,000,000.
. Limit of $375,000 of Tax Credit to any One Company.
. Limit of $25,000 Tax Credit to Individual Taxpayer
DEVELOPMENT CREDIT CORPORATION OF MONTANA
SBIC'S 503 CORP.
PRIVATE DEVELOPMENT COMPANIES
INVESTMENT IN ONE COMPANY LIMITED TO 50% OF CAPITAL BASE
(VENTURE AND RISK CAPITAL)
LOANS,
EQUITY, NEAR EQUITY OR
LEASE PURCHASE AGREEMENTS
MONTANA PRIMARY OR BASIC INDUSTRIES

EXHIBIT B

SCHEDULE

Effective Date of Act (Estimate)	March 31, 1983
Adoption of Rules to (Estimate) Implementation Act	April - November 30, 1983
Application Period	November 30 - April 31
Certification of Capital Companies	March 1, 1984 - And Every Six Months Thereafter
Designation of "Qualified" Capital Companies	September 1, 1984 - And Every Six Months Thereafter

OPERATION

30% Invested Within 3 years
50% Invested Within 4 years
70% Invested Within 5 years

QUARTERLY REPORTS

ANNUAL EXAMINATION

INVESTING IN AMERICA

INITIATIVES FOR COMMUNITY AND ECONOMIC DEVELOPMENT

The President's Task Force on Private Sector Initiatives

EXHIBIT C

6 VENTURE CAPITAL

By The National Association of Small Business Investment Companies

Atari, Federal Express, Air Florida, Pizza Time Theatres, Kentucky Fried Chicken, Hospital Corporation of America, Digital Equipment and Apple Computer all have something special in common. In addition to being highly successful companies, the development of each was financed, in part, by venture capital dollars.

Perhaps no investment area profiled in this book is as dynamic today as venture capital. For a variety of reasons, the field is rapidly changing and expanding, developing innovative financing tools and broadening the scope of venture investing.

Traditionally, venture capital has referred to the money invested by professionals in a selected few small or embryonic businesses, in the hope they will grow and become very profitable. Such investments, by nature quite risky, can mean enormous payoffs for venture capitalists with shares in the earnings of companies that become highly successful.

This classic definition still applies, but only illustrates part of the picture of venture capital investing today. After a relative pausity of activity during the mid-1970s, venture investing is booming. New financing tools are being developed; more traditional ones are seeing a resurgence and being used in new ways. Innovative venture partnerships involving public as well as private participants are greatly expanding the role of venture capital in revitalizing distressed areas and industries. Even the parameters of what constitutes venture capital are expanding: at its broadest, it may today include the dollars invested by employees in the highly risky venture of buying a plant no longer considered profitable enough by the parent owners.

Two essential elements distinguish venture capital financing from other types of business investments. First, venture capital investments usually have strong equity features. Second, venture investors generally remain involved in the management and progress of the businesses they finance, sitting on the firms' boards, almost always as a minority shareholder, and providing counseling, often without cost. These

non-financial contributions are not a matter of charity; they are made because the venture capital investors will profit only if the companies grow.

Between 450 and 500 organized venture capital companies operate in the United States today, holding investments worth more than $6 billion. In addition to the organized and professionally managed venture capital funds--the subject of this chapter--there are hundreds of thousands of individuals who have made true "venture capital" investments—in the birth or growth of small family owned businesses, for example. No precise information can be collected on the magnitude of these informal venture capital flows. But it is important to mention this pool, because it is so critical in the formation of businesses and because government policies can impact heavily on capital formation through this mechanism.

Venture capital firms made record investments in 1981, some $1.4 billion in disbursements, compared with only $250 million in 1975 and $400 million in 1977. Some believe that the industry is growing so fast that there may actually be a shortage of experienced venture capitalists to manage the growing supply of available capital. But while the industry has more than doubled in size in the past five years, it still holds only a tiny percentage of the nation's capital. For comparison take pension funds, with close to $800 billion worth of investments in their portfolios. If pension fund managers were to invest just one percent of their assets in venture capital, the industry would more than double overnight. (Actually, as we shall examine later, many large capital sources, including pension funds and even foreign investors, are beginning to devote more of their assets to venture investments.)

Venture capitalists are highly selective, choosing for investment only a minute percentage of the funding requests they receive. The typical venture firm might review 200 to 300 proposed ventures annually, prepare a detailed analysis for 25 or 30, and fund five. Probably only one of those five will produce significant profits. Investors are looking for entrepreneurs who can develop a new or better product or service which has the potential to fill or create a niche in the market. They are seeking businesses with the potential to grow to a fairly large size rapidly. Key factors in making the investment decisions include technology, market, and business plan, and especially management talent. A cliche in the venture capital industry is that a company with a second rate idea and first rate management is a better investment risk than one with a first rate idea and second rate management. Among the skills the venture firm is looking for are unique technical know-how, a proven management track record, knowledge of manufacturing, marketing and finance, and a high level of commitment to the enterprise.

Since most firms receiving venture capital will not be highly successful, the venture capitalist hopes to make big profits on the 10 percent or so that are. Growth is extremely important. A critical milestone to the venture financier is the ability of a funded company to "go public": that is, to obtain further equity capital through the public sale of stock. Going public usually provides the venture investor the highest return on invested capital.

Since only a small percentage of venture funded firms actually go public, venture financiers have other means for "cashing out" their investments. The venture capitalist can sell shares in successful firms to other investors; some have even proposed creating a publicly supported secondary market to do so. Venture capitalists can cash out if a funded firm is bought by others or merged with another firm. Or the venture financier can negotiate a "put" with a funded firm—that is an agreement to sell the firm's stock or options back to the entrepreneur at some pre-determined multiple of earnings. Generally, "puts" are used when a debt financing instrument is involved. They are agreed upon at the beginning of the venture financing, but are not to be called in for at least five years, and ordinarily not until the funded firm has paid back its loan.

Although the pool of venture capital is small, many believe the industry's investments--because they are heavily weighted toward new technologies and job creating small enterprises—have a disproportionate impact on the nation's economy. The Government Accounting Office, in a 1982 report, Government Industry Cooperation Can Enhance the Venture Capital Process (GAO/AFMD-82-35, August 12, 1982), found: "...this small segment of the U.S. economy has produced disproportionately large benefits to the Nation's productivity and economic well-being." Venture capital funded firms had unusually high levels of productivity and job creation, GAO found in its evaluation of 1332 companies receiving $1.4 billion in venture investments during the 1970s. The $209 million in venture funds invested in 72 firms that eventually went public was ultimately responsible for an estimated 130,000 jobs, over $100 million in corporate tax revenues and $350 million in employee tax revenues, and $900 million in export sales, the report showed. In addition, GAO found, the products produced by venture capital funded firms tended to be productivity enhancing, contributing to the formation and development of new and economically promising industries. Other studies have tended to confirm GAO's conclusions.

Composition of Venture Capital Industry

Private venture capital firms supply about half of all the venture capital invested in enterprises. Most private venture capital firms are organized as limited partnerships. They are managed by a small team of

general partners and financed by limited partners, including pension funds, insurance companies, wealthy individuals and endowments, who invest funds to make up a capital pool. Some private venture capital firms are organized in corporate form; still others are the family funds--the Rockefeller, Whitney and Phipps, for example--which are managed professionally by outsiders. As a group, the estimated 130 private venture capital firms in the United States had committed about $3.3 billion in venture investments as of July 1982.

Sources of Funds

The following table details the major sources of capital committed to the private venture capital companies from 1980 through the first half of 1982.

CAPITAL COMMITMENTS
(Independent Private Firms Only)
(millions)

				Percent of Total Capital Committed		
	1980	1981	1982 (6 mos)	1980	1981	1982
Pensions Funds	$197	$200	$228	30%	23%	32%
Individuals/Families	102	201	115	16	23	16
Insurance Companies	88	132	112	13	15	16
Foreign	55	90	107	8	10	15
Corporations	127	142	90	19	17	13
Endowments/Foundations	92	102	54	14	12	8
TOTAL	$661	$867	$706			

Source: Venture Capital Journal, July 1982.

As the table shows, both pension funds and foreign investments have increased dramatically as a source of venture capital funds, more than equalling their 1981 total in only six months of 1982.

A second category of venture capital organizations are the Small Business Investment Companies (SBICs). Although licensed and regulated by SBA, their investments and management decisions are made on a completely private basis. There is one key distinction between SBICs and other private venture capital firms: SBICs can borrow from SBA (at an interest rate somewhat above the cost of money to the U.S. Treasury) and use these funds for further investments. Minority Enterprise Small Business Investment Companies (MESBICs) provide equity

and debt financing for firms owned by minorities and economically disadvantaged persons. Like SBICs, MESBICs can leverage private dollars with federal dollars creating a pool of capital several times the initial pool. SBICs vary dramatically in size. Many are owned by a relatively small group of local investors. Some are owned by corporations; 20 are publicly owned. Another 70 are owned partially or wholly by commercial banks. The nation's largest SBICs is Citicorp Venture Capital Limited, a subsidiary of Citicorp; it has over $37 million in private capital to invest. As of July 1982, there were 360 SBICs and 125 MESBICs in the United States. They had committed almost $2 billion to venture investments, financing about 1800 firms in 1981 alone.

The final type of organized venture capital firms are the corporate subsidiaries, divided into two categories: financial and industrial. The financial subsidiaries are owned primarily by banks; insurance companies, too, have formed venture capital subsidiaries. (Allstate's is one of the oldest and most successful). In the industrial sector are the venture capital firms owned by such companies as Exxon, General Electric, Xerox, Monsanto, and Emerson Electric. As of July, 1982, corporate venture capital firms had committed about $1.7 billion in investments.

Who Receives Venture Capital

Venture capitalists tend to seek out new technologies, new goods or new services to invest in, and not surprisingly, a large share of the venture capital investments today tend to be in high technology oriented businesses. But venture capitalists are not concerned solely with "growth industries:" they have also made good profits by pioneering investments in "growth companies" in non-high tech fields, or so-called "mundane" industries. Some of the most successful include nursing homes and health care companies, intrastate and regional airlines (Air Florida and Midway Airlines), cable television franchises, and commercial and financial services (Federal Express Corp. and Pandick Press).

The chart on the following page shows the distribution of venture capital investments by industry type during 1980 and 1981.

1981 Disbursements—Private Venture Capital Partnerships

	Percent of Total Number of Investments	
	1981	1980
Communications	11.4%	11.5%
Computer Related	30.0	27.4
Other Electronics Related	14.5	9.6
Genetic Engineering	6.2	4.2
Medical/Health Related	7.0	10.5
Energy	4.9	8.3
Consumer Related	4.9	7.5
Industrial Automation	6.2	4.5
Industrial Products	4.4	3.6
Other	10.5	12.9

Source: Venture Capital Journal, June 1982.

Venture Capital Financing

Venture capital is used for a wide variety of purposes: to develop the ideas for a product, to start businesses, expand them or prepare them for going public. There is no single way to structure venture capital financing. Venture capitalists often buy common stock in a business, exchanging capital for a "share" in the enterprise, usually taking a minority ownership position. Or they may purchase preferred stock, usually convertible into common stock, giving the financier a share of earnings before anyone else, but little or no voting rights. Another popular equity-type instrument in venture financing is convertible debt, where in addition to a commitment to interest and principal repayment (usually long-term), the enterprise gives the venture financier the right to convert debt notes into common stock. Subordinated long-term debentures are another common form of financing; in the event of default on this kind of loan, the lender is paid only after senior creditors, such as banks or commercial finance companies, who have prior claim on a firm's assets, are paid off. A venture firm may also assist a small business by guaranteeing loans or advances made by senior creditors. Most often, the venture capital financing is structured by using two or more of these instruments. In every case the format is different, designed to meet the specific needs of the business and the investor.

For the small firm, each type of financing has certain advantages. The sale of common stock strengthens the balance sheet of a growth firm, enabling it to borrow more from traditional lenders. But the entrepreneur must give up a larger share of the ownership of the business, than would be the case if some of the financing were in the form of debt. Preferred stock carries an obligation to pay dividends out

of after-tax income when the firm is profitable. Loans from venture capital firms are almost always long-term--seven years is the average for SBICs--and ordinarily subordinated to all other borrowings of the firm, to encourage senior creditors to extend and expand their line of credit.

One increasingly popular kind of venture arrangement is the "leveraged management buy out," where the management of a corporate subsidiary or division, together with an investor or investor group, purchases the subsidiary or division. The equity contributed by the investor and management purchasers is usually only 20 to 30 percent: the remainder is borrowed from banks and other institutions. The seller is usually a large corporation which has not achieved the benefits it expected when it either formed or bought the subsidiary or operation.

Financing Stages

Venture capital may be provided to firms at varying stages of development, each carrying different risks and payoffs for the financier. Early stage money, for example, may promise the greatest profits if the firm is successful, but also carries the most risk, requiring more hands on involvement for the venture firm and the possibility of open ended financial commitments.

The following chart shows the six financing stages for a developing business. These are not rigid or fixed, however. Venture capital can be used in any stage.

Early Stage:

Seed Financing—a relatively small amount of capital provided to an investor or entrepreneur to prove a concept. It may involve product development but rarely involves initial marketing. This kind of investment is sometimes referred to as "adventure financing."

Startup--financing for use in product development and initial marketing. Companies may be in the organization process or they may have been in business a short time (one year or less), but have not sold their product commercially. Usually, such firms would have assembled the key management, prepared a business plan, made market studies, and generally prepared themselves to do business.

First Stage Financing—financing provided to companies that have expended their initial capital (often in developing a prototype) and require funds to initiate commercial manufacturing and sales.

Expansion:

Second Stage Financing--working capital for the initial expansion of a company which is producing and shipping, and has growing accounts receivable and inventories. Although the company has clearly made progress, it may not yet be showing a profit.

Third Stage Financing--funds provided for major expansion of a company whose sales volume is increasing, and that is breaking even or profitable. These funds are utilized for further plant expansion, marketing, working capital or an improved product.

Fourth Stage (Bridge) Financing--financing for a company expecting to go public within six months to a year.

The venture capital industry has gone through several swings in its financing patterns. Seed and start-up financing flourished during the 1960s, when venture firms stressed new business creation over on-going development. That reversed in the mid-1970s, when start-ups fell to only 10 percent of venture financing; today, early stage financing is again being emphasized, accounting for 52 percent of the 1981 venture dollars invested.

SBICs, which must pay interest on their loans from SBA, tend to invest in enterprises that are slightly more established. Only about one third of the firms financed by SBICs in 1981 were start-ups, while more than 13 percent were over 10 years old. More than 60 percent of SBIC dollars, however, went to firms less than three years old. Two thirds of the dollars invested by SBICs were used by recipient firms for operating capital.

Origins of Organized Venture Capital

Throughout its history, the United States has depended on venture capital to fuel its economic growth. George Washington and many others provided the funds for digging canals and building roads and railroads; later the duPonts helped finance General Motors; Mellon dollars built Gulf Oil and Alcoa; the Rockefellers took some of their oil dollars to fund Eastern Airlines. Less dramatic are the hundreds of thousands of examples of relatively small investments by family members and friends in hometown success stories in all parts of the country.

As an organized industry, venture capital was not highly visible before 1946, when the American Research and Development Corp.

(AR&D) revolutionized the nature of venture investments. Family funds, such as those organized by the Rockefellers, the Whitneys, and the Phipps were operating, but without publicity, so the typical entrepreneur had no access to these sources of venture funding.

AR&D, organized by a group of New England business leaders and headed by Gen. Georges Doriot, a Harvard Business School professor, was formed solely for the purpose of making venture investments. It supplemented its initial private capital by several public offerings of its stock; the resulting capital pool was invested heavily in high technology companies. Like the venture capital firms of today, AR&D gave managerial assistance and technical advice to its portfolio firms. In 1957, AR&D added to its portfolio a $70,000 investment to start a firm called Digital Equipment. Digital Equipment experienced early financial problems. But as the company matured, its value increased until AR&D's initial venture investment had evolved into a holding worth more than $300 million. AR&D's experiences helped convince others of the profits to be made in venture investing.

The next milestone in the development of the venture capital industry was the 1958 Small Business Investment Act, which authorized the SBIC program. Also that year, Congress took several actions in the tax field which had the effect of promoting capital formation for smaller firms and assisting in the formation of new businesses. These included: permission for closely-held corporations to elect to be taxed as partnerships; authority for losses on investments in small businesses to be written off against ordinary income; and the beginning of a graduated tax rate on corporate income.

Many SBICs were organized during the 1960s, and in the late 1960s and early 1970s, a number of venture capital firms were formed, many as partnerships but some as corporations and others as subsidiaries of major firms. In 1969, the SBIC pattern was extended to minority firms with the establishment of the MESBIC program.

After the rapid growth of the industry in the 1960s, many SBICs and venture capital firms left the business in the mid 1970s, due in part to changes in federal tax and regulatory policies and the depressed state of the over-the-counter securities market. In 1978, the industry began to revive as rates of return for venture firms improved and as new tax and other federal policies provided greater incentives for venture investments.

During the venture capital industry's relatively short existence, the highly visible success stories of venture backed firms such as Apple Computer, Control Data, Teledyne, Intel, Amdahl, Federal Express and Cray Research have continued to encourage expansion. Today venture capital companies tend to be concentrated in six or eight major

metropolitan areas, including Boston, New York, Chicago, Minneapolis, Dallas, San Francisco and Los Angeles, although more geographic dispersion is occurring as new firms are established. The enterprises receiving venture investments also tend to be concentrated in a few states--California, Massachusetts, and New York, for example—where high technology firms are plentiful. Those three states accounted for 57 percent of the venture capital disbursements in 1981.

The Impacts of Federal Policy

Venture capital firms, depending on type, experience varying degrees of government regulation. SBICs and MESBICs are regulated by SBA; those that are publicly-owned are also regulated by the Securities and Exchange Commission, under either the Investment Company Act of 1940 or the Small Business Investment Incentive Act of 1980. Publicly-owned private venture capital firms are also regulated by SEC. The other segments of the venture capital community are free from any regulatory framework, but as is the case with all parts of the industry, must operate under federal and state securities laws.

Many students of the venture capital industry believe federal tax and regulatory policies have an important impact on the flow of venture capital to new enterprises. "The venture capital process is very sensitive to government policies, rules and regulations," concluded GAO in its comprehensive report. The Tax Acts of 1969 and 1976, which raised the federal tax rate on capital gains from 25 percent to 49 percent and altered the tax treatment of stock options, are frequently cited as contributing to the decline of venture investment activity in the 1970s, when disbursements dropped from nearly $500 million in 1969 to $250 million in 1975.

The federal actions may have had a ripple effect on venture financing and new enterprise formation, GAO concluded. With the perception of reduced capital availability, entrepreneurs became less inclined to pursue new business ventures. With stock options less attractive, experienced managers and technocrats became less inclined to abandon secure careers for entrepreneurial ventures. Venture capital firms tended to shift from start-ups to more short-term investments in existing businesses, and, GAO found, the number of venture firms declined.

The number of companies going public also declined significantly during the early 1970s, from an annual average of 721 from 1968 to 1972 to only 55 in 1974 and an average of 45 from 1975 to 1978. Some believe the federal tax laws and securities regulations were largely responsible for the decline in the number of new issues; others cite generally poor economic conditions during the 1973-1976 recession as the key factor. Whatever the cause, the poor securities market was an

impediment to venture financing.

In 1978 Congress cut the tax rate on capital gains back to 28 percent, and venture funding, which had been increasing slowly since the lowpoint in 1975, shot up dramatically, from around $400 million in disbursements in 1977 to $1 billion in 1979. Congress lowered the rate again in 1981, to a maximum of 20 percent, and reversed the changes in stock option provisions that had been enacted in 1976. Another government regulatory action cited as having a significant impact in encouraging venture financing was the decision by officials at the Labor Department to take a more liberal view of the "prudent man" requirements of the Employee Retirement Income Security Act of 1974, governing the investment of pension fund assets, to allow for some more "risky" investing.

CASE EXAMPLES

The Private Venture Capital Firm: Oxford Partners

Like most private venture capital companies, Oxford Partners operates as a limited partnership. Oxford Partners manages the Oxford Venture Fund, a $20 million capital pool, made up of investments from pension funds, corporations, wealthy individuals, insurance companies, bank trust departments, and others.

Oxford Partners began in June 1981. It now has nine investments in its portfolio, all high technology oriented companies, with names such as Aspech, Queue Systems, RF Monolithics, Faded J, and Micro General. Oxford generally makes equity investments, usually purchasing common or preferred stock. It stresses early stage financing.

Oxford Partners will only consider business plans submitted for financing. It receives somewhere around 50 funding requests per month, from which fewer than one percent are selected.

The SBIC: Northwest Growth Fund

Founded in 1961, this Minneapolis-based company has been one of the nation's largest and most successful SBICs, investing more than $65 million in 165 companies. In the late 1970s Northwest Growth purchased two other SBICs, in Portland and Denver. In 1979 it became a wholly-owned subsidiary of Northwest Bancorporation, the 18th largest bank holding company in the U.S.

As of mid-1981, Northwest Growth Fund held over 65 companies in its portfolio: many were in high technology, but the firm's investments are quite diverse, in such areas as machining, medical products and pharmeceuticals, chemical agriculture, education and computer assisted

design and manufacturing. The only kind of venture Northwest Growth will not invest in is real estate.

Between 1975 and 1980, the firm's net asset value grew at a compounded annual rate of over 50 percent. Firms funded by Northwest Growth employed 15,000.

For most of Northwest Growth's investments, the fund takes an equity position in its enterprises, using a combination of convertible debt securities and common and preferred stock. The fund also provides management assistance, and usually sits on its firms' boards of directors as a minority shareholder.

Revitalizing Distressed Areas: Kentucky Highlands Investment Corporation

Increasingly, venture capital financing tools are being used to stimulate economic activity in distressed communities. One excellent example is the Kentucky Highlands Investment Corporation, a community development corporation which has taken a venture capitalist approach to community and business development. KHIC supplies risk capital and management assistance to entrepreneurs wishing to start or expand businesses in a 12-county region of Eastern Kentucky, where per capita income is far below the national average and unemployment is high.

KHIC is nonprofit, but it has established two for-profit development subsidiaries: Mountain Ventures Inc., an SBIC, and Kentucky Highlands Real Estate Corporation, which has begun developing industrial properties.

KHIC tends to invest in manufacturing companies, generally low technology, labor intensive industries, but will also consider wholesaling and service ventures. KHIC uses many different types of financing arrangements, buying common or preferred stock, and issuing convertible and subordinated long-term loans. About two-thirds of its financing is in debt form. It also provides a wide range of management services.

Since 1971, KHIC has invested close to $5 million in 19 companies, employing nearly 500 area residents. Among KHIC supported ventures are Possom Trot Corporation in McKee, Ky., manufacturer of soft toys and tote bags, Outdoor Venture Corporation, producer of camping tents, and American Bag Co., producer of sleeping bags, in Pine Knot, Ky.

KHIC built its capital pool using a combination of public and private dollars. Initially it received federal funds primarily from the Community Services Administration, but since 1982 has been privately financed.

State Supported Venture Capital Funds

An increasing number of states are establishing venture capital type funds to help finance development within the state of new products or technologies, or to revitalize distressed communities.

+ The **Connecticut Product Development Corporation**, a quasi-public agency authorized by the Connecticut legislature in 1972, supplies equity capital to small enterprises within the state that wish to develop new products, expand production or diversify. In return for its investment, the CPDC receives a royalty on each product sold.

CPDC will fund up to 60 percent of the development costs of a new product: the company is expected to raise the remainder. CPDC funds may not be used for working capital or the purchase of land, equipment or buildings. If the product reaches the marketplace, CPDC receives a royalty of 5 percent of the sales until the grant has been repaid five times. One important advantage of CPDC's funding approach is that the payoff to the venture financier, in this case CPDC, depends only on the success of the product, not on the ability of the producing firm to go public or be acquired by another firm, as is normally the case in venture investing.

CPDC, modeled on the British National Research Development Corporation, established in 1948 to help speed post war recovery, was initially capitalized with $10 million in state bond funds. By June 30, 1982, the corporation had committed more than $5.3 million to 39 small firms and was collecting more than $500,000 annually in royalties. Among the 46 products financed to date are laser equipment to inspect newly manufactured machine parts, computer software packages, solar heating panels, a freezing technique to better preserve food flavors, computerized business telephones, bathroom scales and an electronic file cabinet.

+ Like CPDC, the **Massachusetts Technology Development Corporation** uses public venture financing to encourage the development of high technology companies. The corporation generally supplies seed capital in the form of subordinated debt.

Four criteria govern MTDC investments: the venture must have an innovative technology; it must have a reasonable chance of commercial success; private sector financing must be involved; and the investment should yield benefits to Massachusetts through by creating jobs and stimulating economic development.

+ Massachusetts and Louisiana are among a growing number of states which have established venture funds to stimulate economic activity in distressed areas. The Massachusetts Community Development

Finance Corporation was established in 1975 to make investments in community-based ventures in low-income areas across the state. The Louisiana Small Business Equity Corporation supplies financing for small firms that contribute to increased employment and economic activity in the state, that are owned by disadvantaged persons, or that invest in distressed areas. Recipient firms must show they are capable of providing at least $1 of private capital for every $4 they receive from the state.

Innovative Private Venture Capital Funds

+ The Massachusetts Capital Resource Company is a partnership of nine life insurance companies in Massachusetts which, in return for tax relief granted by the state, are providing venture capital to in-state businesses. MCRC is for-profit. Now capitalized at $100 million, it supplies four basic types of investments: long-term loans to companies unable to borrow from conventional sources, subordinated debt to rapidly growing firms, investments with others to revitalize existing businesses, and growth capital to young firms. MCRC will finance all sizes of businesses, but is prohibited from investing in real estate developers, retailers, construction companies, public utilities and most financial intermediaries.

By November 9, 1982, MCRC had invested over $81.5 million in 72 firms, with individual investments ranging from $100,000 to $5 million. Its earnings exceeded $5 million in 1981.

+ The Minnesota Seed Capital Fund was organized in 1980 by several Minnesota corporations as a for-profit venture to provide start up money, or so-called "angel funds," primarily for high technology companies in the state. Its initial corporate contributors included Control Data Corp., Dayton-Hudson Corp., Data Card Corp., Piper, Jaffray and Hopwood, Inc., Northern States Power Co., Carlson Cos. and the Minneapolis Star and Tribune Co. In 1982, two large pension funds announced their participation: Control Data pension fund committed $500,000, as did the public Minnesota Employees Retirement Fund (MERF).

The fund works closely with the Minnesota Cooperation Office, an independent, nonprofit organization formed by the business community to advise small firms. All potential recipients of Seed Capital investments must go first to the MCO, which is staffed by volunteer business professionals, to receive assistance in preparing a business plan. Once a firm receives an investment, however, the Seed Capital Fund, unlike some venture capital financiers, is not heavily involved in its management.

As of November, 1982, the Seed Capital Fund had $3.2 million in capital, of which $866,000 had been committed to seven firms. These

included Audiobionics, developer of computer aided systems for the deaf; Multi-Arc Vacuum Systems, Inc., a company specializing in increasing the durability of high speed machine tools; DataText Systems, Inc., a computer graphics company; Magnetic Data Inc., which helps refurbish magnetic disks for computers; and Mid-American International Trading Co., the Fund's only non-high technology investment, which assists small Minnesota businesses in marketing products worldwide.

The Seed Capital Fund's investments generally take the form of preferred or common stock, and to date have not exceeded $250,000 to any single company.

THE MONTANA CAPITAL COMPANY ACT

HOUSE BILL NO. 685

TESTIMONY TO THE SELECT COMMITTEE FOR ECONOMIC DEVELOPMENT

THE HOUSE OF REPRESENTATIVES

STATE OF MONTANA

FEBRUARY 10, 1983

BY JON MARCHI

I very much appreciate the opportunity to provide this Committee with testimony regarding what I believe to be the most important Bill developed from the Governor's temporary Committees concerning Initiative 95. I have lived in Montana since I was 3 years old, in various locations throughout the State. This Bill is unique in that it provides Montanans with a way and a facility to help themselves create and maintain more jobs in our State. Currently, I am a Vice President with D.A. Davidson & Co. I have been with D.A. Davidson for the past 10½ years and my current responsibilities include research, recruiting, marketing, training and special products. Mr. Bill Beaman, our office manager here in Helena, provided you with testimony last week concerning D.A. Davidson's position in regards to Initiative 95. Having been with Montana's oldest investment firm for the past 10½ years, I have had the opportunity to experience the critical need for venture and equity capital for Montana businesses. Also, I am a Director of Big Sky Airlines of Billings, Montana, which now employs 130 people and, in terms of net new jobs, is perhaps the best current success story in the State of what an adequately-funded company on an equity basis can do.

I served as the Chairman of the Governor's temporary subcommittee for equity and venture capital development for Initiative 95. Our Committee developed the Montana Capital Company Act.

A quick over-view of what I consider to be the key points concerning this Bill:

1. As Legislators, you have the unique ability to create economic events through tax policy and tax legislation.

EXHIBIT D

2. Our Committee, in developing the Montana Capital Company concept, did not try to re-invent the wheel.
3. We already have nine (9) different types of tax credits on the books that are available to taxpayers on both a Federal and State level.
4. The "yes" vote for Initiative 95 was, as I understand it, the highest "yes" vote for any initiative to date passed in the State of Montana. In my discussions with individuals and businessmen throughout the State of Montana, the point has been made that when those voters were voting "yes", they were voting for the Legislature to develop a concept that would hopefully provide not only debt capital, but equity capital, for new and existing businesses to expand the number of jobs available in Montana.
5. The Bill is specifically designed to address the equity capital needs. The Bill establishes public incentive for the private sector to act. This Bill is perhaps different than the other three bills related to Initiative 95 in that those bills generally require the public sector to act whereas the Capital Company Bill is a much more private sector orientated proposal.
6. This Bill does not provde for an expenditure of State funds. It provides for an investment of State funds in the private sector. Those funds, through tax credits, should in time create additional jobs and those jobs should in time create additional tax revenues back to the State.

I have provided a packet of information for each of you, which includes my testimony, a copy of the Bill as it originally came out of our subcommittee at the end of December, and my proposed amendments to the Bill as it has been introduced in the House.

The purpose of the Bill is simply and most importantly to develop and preserve jobs in Montana. The Bill creates a new financial institution--"a capital company" to make available equity or quasi equity--"borrowing base" capital to existing and new Montana businesses. Most importantly, the Bill provides for the individual and corporate residents of Montana an opportunity to invest and participate in an organized manner in the economic development potential for the State. The idea is to forge a new partnership with the State Government and private enterprise that is mutually compatible as to job creation and preservation.

A capital company can be a corporation, a partnership, an S "S Corporation", SBIC or a local development company whose purposes are compatible with the objectives defined.

The capital company must be certified by the Department of Commerce and an annual audit and review is required at the capital company's expense. Decertification would involve substantial penalties.

CRITERIA AND REQUIREMENTS:

A minimum of $200,000.00 in net private equity capital must be raised in order to apply for certification as a capital company.

30% of the equity capital raised must be invested in qualifying businesses within three (3) years, 50% in four (4) years, and 70% in five (5) years to maintain the certification.

No more than 50% of the capital company's total capitalization can be invested in any one business. This provides diversification of the capital company's assets.

Any user of the capital cannot vote for his own interests; that is, he must abstain from voting.

The intent is to let the capital companies operate with as few restrictions as possible. Free of undue regulation and interference. Let the market place dictate the best opportunities. For example, in Alberta, the provincial government provided $200 million and very favorable financing to their venture capital organization, which they call the Alberta Opportunity Company. That Company's purposes are compatible with our capital company proposal. Their capital corporation is structured as a private company owned and operated as a public company. Securities have been sold to the public to provide the equity base. The Company operates with virtually no restrictions. Its purpose is very comparable to our proposal.

Advantages to an investor in a capital company is that he will receive a 25% State income tax credit. Our Committee originally recommended 50% but at the Governor's request, it was reduced to 25%. As I indicated earlier, tax credits dictate economic events, in my opinion. For example, recently we at D.A. Davidson sold limited partnership units in Times Square ($600,000.00), a commercial rehab shopping mall in downtown Great Falls. The primary advantage to an investor was a 42% Federal tax credit and a 12.6% State tax credit, for a total credit of 54.6% of his total cash investment. In time, the project will create fifty new retail-type jobs and has a total construction budget in excess of $3.5 million.

Other States have provided their venture capital companies with State income tax credits. The most successful has been Massachusetts, which raised over $100 million for in-State venture capital companies over a five-year period.

Massachusetts provided a 100% State tax credit of the amount of investment. The second most successful has been Indiana, who provided a 30% tax credit and raised $8 million. Maine provided a 50% credit but spread the credit 10% per year over five years and was only able to raise $1 million.

In the current Bill, the amount of tax credits available is $1 million, which would equate to $4 million at a 25% tax credit rate. Originally, the Bill came out of our temporary subcommittee with a recommendation of $3 million in tax credits. There is a limitation of no more than $25,000 in tax credits per individual or corporation, which would equate to a maximum investment of $100,000. If one attempted to form a rather rough calculation of what these tax credits might produce in the way of jobs, the following scenario is well within the realms of possibility: assume that the $4 million was raised, which generates the $1 million in maximum tax credits. "By the way, I think it will be very difficult in this competitive money market environment to raise $4 million." The current EDA Guidelines are that it requires about $10,000 in investment to create one primary job. $4 million would then create approximately 400 primary jobs. Currently, in Montana, one primary job would typically create an additional one and one-half derivative jobs; or, in this case, another 600 jobs, for a total of 1,000 jobs. Assume that there are 1,000 individuals who earn, on an average, $12,000 per year or a $12 million annual payroll. Assume a 6% State income tax rate on that $12 million payroll or $720,000 in State income taxes. This does not take into consideration increased property taxes from new construction and so forth. In this scenario, the State would have recovered its tax credit money through increased State income tax collections from individuals in about two years or so. That's a good return on the investment.

As I indicated earlier, Massachusetts was very successful in raising $100 million for their in-State venture capital companies through a 100% tax credit. Currently, Massachusetts has the lowest unemployment rate of all industrial states in the nation. Secondly, according to the Governor, there are currently only three States in the Union whose revenues will exceed expenditures in their current fiscal year. Those States are Massachusetts, Alaska, and Montana. The concept has been proven.

As I indicated earlier, in your packet is a copy of the Bill as it originally came out of our temporary subcommittee. The Bill originally contained an income bond debenture as part and parcel of the capital company concept. I continue to believe that this is an excellent idea but, as the Bill is presently written, my support for it has not been diminished in its present form.

I am proposing a few amendments to the current Bill, some of which I think are quite important. On Page 7, Lines 17 thru 21, starting with the words "The application" should simply be deleted. The Department of Revenue came up with the idea that a capital company should be required to post a bond to cover the cost of any penalty. This is simply too onerous and too unwieldy, and as the Bill stands as written, the odds are not good for this concept to be successful. It is important, I think, to keep the concept as free and clean of restrictions as possible, as other States (particularly Alberta and Massachusetts) have done.

Also on Page 7, Line 24, I would propose that $500,000 be inserted for $375,000. It is very important for these capital companies to be large enough to adequately diversify their investment base and to have a sufficient capital base to be able to afford the best expertise in the area of venture capital financing. On Page 7, I would propose the deletion of Lines 23, starting with the word "the" and ending with Line 2 on Page 8. In other words, the deletion of Lines 23, 24, 25 and 1 and 2, Pages 7 and 8 respectively.

The only other amendment I would propose is that on Page 11, Lines 6, 14 and 21, that the word "Annual" be inserted for the present word "Quarterly". There is absolutely no need to require that a capital company report quarterly to the Department of Commerce when an annual review and audit will be conducted anyway at the capital company's expense. In closing, I would like to reiterate that I strongly support the Bill in its present form, with the exceptions of the amendments that I have just proposed. Secondly, I would encourage you to consider utilizing a higher percentage tax credit than 25%, and I would encourage you to consider the income bond proposal as outlined in the original Bill.

Thank you.

Jon Marchi

sl

Article taken from the Montana Standard
Tuesday, July 29, 1975

W H A T ' S W R O N G ?

EDITOR'S NOTE -- Jim McLean of D.A. Davidson & Company in Butte, reports that the following commentary, from the old Park County News in Livingston, was found among the possessions of his wife's aunt, who died recently at age 90. There was no date on the clipping, but McLean feels the article, entitled "What's Wrong With Montana?" remains timely.

"NOTHING'S WRONG with Montana except entirely too many of us get up in the morning at the alarm of a Connecticut clock, button on a pair of Chicago pants and put on a pair of Massachusetts shoes, wash in a Pittsburgh tin basin, using Connecticut soap and a towel made in New Hamphire, sit down to a Grand Rapids table, eat pancakes made from Minnesota flour, spread with Vermont maple syrup and Kansas bacon fried on a St. Louis stove, buckle on a leather coat raised in Montana then shipped to Europe, labeled "Imported," and sent back to Montana at double the price, hitch up a Detroit mule fed on Oklahoma gas to an Ohio plow and work all day on a Montana farm covered by New England mortgage. At night we crawl under New Jersey blankets to be kept awake by a sheep dog, the only home product on the place, and wonder where all the money went from our wonderful state."

EXHIBIT E

R. A. Remington
Montana Vice President

Mountain Bell
560 North Park Avenue
Helena, Montana 59601
Phone (406) 449-2211

Testimony in Support of House Bill 685

Mr. Chairman and members of the committee:

My name is Dick Remington, Montana Vice President for Mountain Bell, and President of the Development Credit Corporation of Montana.

The Development Credit Corporation is a private, for-profit business development corporation chartered under Montana state law. Our shareholders are many of the state's financial institutions, a few large corporations operating in Montana, and half a dozen rural electric cooperatives. We have an existing capitalization of about $250,000 and are the only organized financial institution in Montana capable of providing risk and equity capital to worthy Montana businesses.

We enthusiastically support the passage of House Bill 685 as a well designed and thoughtful approach to providing incentives for the private sector to meet the risk and equity capital needs of Montana's small business community. As you may know, there exists a strong consensus among Montana's financial and business community that we lack access to venture capital, and that this is likely the most serious capital problem facing our small business people.

EXHIBIT F

The Development Credit Corporation is designed to be in the business of providing risk and equity capital. In simple terms, this is capital which is not available from conventional financial institutions, due to either size or term requirements, level of risk or sufficiency of equity. For example, let's assume a business is being started which needs $500,000. The local bank may lend up to $250,000 but the owners only have $50,000 in cash. The $200,000 gap in financing may be filled by what I refer to as risk or equity capital. Types of financings which fall in this category include subordinate or convertible debt, usually of a longer term nature, purchase of preferred or common stock in the business, or purchase and leaseback of real estate and equipment.

There has been little, if any, institutional capacity to supply this kind of capital in Montana. In 1981, only four percent of the venture capital investments made nationally were made in the entire eight-state Rocky Mountain region. The national venture capital industry simply grew up where the money and deals existed, namely the east and west coasts, and Minneapolis area. Our remoteness from these areas, and perceived lack of high technology and high growth businesses has kept this source of funds from being made available to our business sector.

What does this have to do with HB 685? House Bill 685 simply establishes tax credits for investors in companies like the Development Credit Corporation. We need to offer potential investors this additional financial incentive in order to raise significant amounts of new capital which will allow us to aggressively pursue venture capital investing. In Montana, it is extremely difficult to raise capital for an in-state venture capital company, particularly when the return to the investors will not be realized for at least three years, and up to seven years.

Several important points must be remembered. First, out-of-state venture capitalists are not generally interested in Montana, for reasons mentioned above. Second, we must develop an in-state private sector institutional capability to supply risk and equity financing tailored to our unique economic environment. Third, our company needs a large capital base in order to vigorously pursue venture capital investing. This bill provides a critically needed incentive to spur investment from the private sector in capital companies such as ours, and I urge you to give it a do pass recommendation.

1982 Venture Capital Directory

Today's venture capital industry is in a state of dynamic flux. Not only is it continually evolving but its needs and preferences are perennially changing. Venture's fourth annual **Venture Capital Directory** is designed to help entrepreneurs recognize the current trends in the industry and put them in touch with those venture capitalists who can best serve their needs today.

The venture capitalists who have paid to be listed in this year's directory are interested in qualified proposals for venture financing and investing in those that best meet their criteria. However, they want to inform entrepreneurs of their current areas of interest and specialization.

Indeed, today's venture capitalists have sharply defined areas of interest and specialization. A venture capitalist who finances only buy-outs and acquisitions is not interested in start-ups and first-round financing. Similarly, one who lists a preference for projects situated in the Midwest is not going to trudge all the way to the Northeast. There's also the question of industry preference. A venture capitalist who has only been involved in oil and gas financing may not have the expertise or interest in evaluating a communications venture. In contrast, however, venture capitalists are more than eager to examine those proposals that fall within their area of stated preferences and consider their financing needs.

Approaching venture capitalists is not the easy task it once may have been. Myth has it that even ideas hastily scribbled on the back of an envelope could get financed in the first heady days of venture capital. Not any more. Venture capitalists are professional investors with formally defined goals who expect a similar degree of professionalism from entrepreneurs. They expect all entrepreneurs to be fully prepared and armed with a comprehensive plan for the venture they want financed.

A good business plan forms the cornerstone of successful venture financing. It distills the market conditions, the technical and professional expertise and the finances that will form the basis of the business. It must clearly describe the people involved in a venture, the market the entrepreneur is seeking and the product that will be sold.

A business plan need not be unduly lengthy or complicated. It must, however, be informative and relevant and present a proposal's basic components: a market overview; a description of the company and the product; a series of strategy programs for the next five years in at least five key areas (manpower, product development, marketing, manufacturing and finance); and financial statements. An excellent guide to writing plans is "How to Prepare and Present a Business Plan" by Joseph Mancuso, published by Prentice Hall.

Once the plan is complete, it's time to select the right venture capitalists to approach. Gone are the days when they could be reached at random through scattershot mailings. These days, most venture capitalists expect each business proposal to be accompanied by an introductory letter on the company's letterhead—a personalized approach that is radically different from the early mass mailing ones. In fact, one venture capitalist emphasizes that the only proposals he looks at are those that have the personal approach.

You can save yourself and the venture capitalist a lot of time and aggravation by carefully choosing those who have an expressed interest in your area and reaching them with carefully targeted proposals. The venture capital firm, listed alphabetically in this directory, have all stated preferences with respect to project, geography and industry. A careful examination should help you determine the firms that will be most responsive to you.

Venture Capital Directory

ADLER & COMPANY
280 Park Avenue
New York, NY 10017
(212) 986-3010

755 Page Mill Road
Suite A140
Palo Alto, CA 94304
(415) 494-0501

Contact:
Frederick R. Adler, James R. Swartz, Arthur C. Patterson, James J. Harrison (CA)
Type of Firm: Private venture firm
Preferred Project:
No preference
Geographic Preference:
No preference
Industry Preference:
Data Communications, Computer & Electronic Fields, Medical Instrumentation, Health Care, Automation

ADVANCED TECHNOLOGY VENTURES
50 Broad Street
New York, NY 10004
(212) 344-0622

530 Oak Street
Menlo Park, CA 94025
(415) 321-8601

Contact:
T. F. Walkowicz (NY)
R. J. Nunziato (CA)
Type of Firm: Private venture firm
Preferred Project:
No preference
Geographic Preference:
No preference
Industry Preference:
High Technology

ADVENT CAPITAL COMPANIES
111 Devonshire Street
Boston, MA 02109
(617) 725-2300

525 University Avenue, Suite 420
Palo Alto, CA 94301
(415) 328-1210

Contact:
David D. Croll, Managing Partner
E. Roe Stamps IV, General Partner
Richard H. Churchill, Jr., General Partner
Jeffery T. Chambers, Associate (CA)
Type of Firm: SBIC
Preferred Project:
Co. 1 to 3 years—break even to profitable
Management buyouts and acquisitions
Geographic Preference:
No preference
Industry Preference:
Cable TV, Broadcasting, Cellular Radio, Health Care, Manufacturing, and Technology

ATLANTIC VENTURE COMPANY, INC.
424 North Washington Street
Alexandria, VA 22314
(703) 548-6026

P.O. Box 1493
Richmond, VA 23212
(804) 644-5496

Contact:
Wallace L. Bennett (Alexandria)
Robert H. Pratt (Richmond)
Type of Firm: Private venture firm
Preferred Project:
No preference
Geographic Preference:
No preference
Industry Preference:
No preference

R.W. ALLSOP & ASSOCIATES
Corporate Center East, Suite 210
2750 First Avenue, N.E.
Cedar Rapids, IA 52402
(319) 363-8971

Contact:
Robert W. Allsop Paul D. Rhines
Gregory B. Bultman
(Milwaukee, WI—(414) 271-6510)
Robert L. Kuk
(St. Louis, MO—(314) 434-1688)
Larry C. Maddox
(Overland Park, KS—(913) 642-4719)
Type of Firm: Private venture firm
Preferred Project:
Co. 1 to 3 years—break-even to profitable
Co. 3 years and older—profitable
Management buy-outs and acquisitions
Geographic Preference: Midwest
Industry Preference: Manufacturing—Medical, Telecommunications

ALLSTATE INSURANCE COMPANY
Venture Capital Division E-2
Allstate Plaza
Northbrook, IL 60062
(312) 291-5681

Contact:
Charles L. Rees
Type of Firm: Venture capital subsidiary of operating company
Preferred Project:
No preference
Geographic Preference:
No preference
Industry Preference:
No preference

(11 pages following not included)

October 13, 1982

We are pleased to announce the formation within our Corporate Finance Division of the

Technology Financing Group

to specialize in investment banking for growth companies in data processing, telecommunications equipment, office and factory automation, and medical technology.

Corporate Finance Professionals comprising the Technology Financing Group include the following:

John S. Dulaney
(212) 399-6160

Brian T. Bristol
(212) 399-3168

Chad Whitney Keck
(212) 399-6360

Robert K. McNamara
(212) 399-3068

Carroll R. Wetzel, Jr.
Mergers and Acquisitions
(212) 399-4606

The Technology Financing Group will draw extensively on the professional capabilities of various other departments of our firm, in particular:

Venture Capital

Michael J. Myers
President,
Smith Barney Venture Corporation

John B. Poindexter

David S. Lobel

Walter C. Johnsen
San Francisco

Investment Research

Data Processing
Peter Labé
Jean W. Orr

Electronics
James W. Barlage

Telecommunications
Special Situations
Susan Hirsch

Computer Services
H. Lloyd Kanev

Medical Technology
D. Larry Smith
Joseph D. France

Limited Partnership Financing

William M. Folberth III
Co-Manager
Tax Advantaged Investments

Stephen Treadway
Co-Manager
Tax Advantaged Investments

Smith Barney, Harris Upham & Co.
Incorporated
1345 Avenue of the Americas, New York, New York 10105

10 LARGEST INDEPENDENT VENTURE CAPITAL FIRMS

T.A. Associates $105 mm
111 Devonshire
Boston, Mass. 02101
(617) 725-2300

J. H. Whitney & Co. $100 mm
630 5th Avenue
New York, N.Y. 10017
(212) 757-0500

Adler & Co. $100 mm
280 Park Avenue
New York, N.Y. 10017
(212) 986-3010

Warburg E M Pincus & Co., Inc.
277 Park Avenue
New York, N.Y. 10017 $81 mm
(212) 573-0300

New Court Securities Corp. $77 mm
1 Rockefeller Plaza
New York, N.Y. 10017
(212) 757-6000

Welsh, Carson, Anderson & Co.
45 Wall Street
New York, N.Y. 10017 $53 mm
(212) 422-3232

Kleiner Perkins Caufield & Byers $70 mm
2 Embarcadero Center
San Francisco, CA. 94111
(415) 421-3110

Idanta Partners $95 mm
3344 N. Torrey Pines Court
Suite 200
La Jolla, Calif. 92037
(714) 455-5280

Sprout Capital Groups $78 mm
Donaldson, Lufkin & Jenrette
140 Broadway
New York, N.Y. 10005
(212) 943-0300

Golder, Thoma & Co. $60 mm
Suite 630
120 South LaSalle
Chicago, Ill. 60603
(312) 853-3322

DEVELOPMENT CREDIT CORPORATION OF MONTANA

P. O. BOX 916
HELENA, MONTANA 59601

TELEPHONE
442-3850

Testimony in Support of House Bill 685

Mr. Chairman and members of the committee:

My name is Dick Bourke and I am the Vice-President of the Development Credit Corporation of Montana. As you heard from Mr. Remington, our corporation enthusiastically endorses the approach to solving our risk and equity capital problems contained in House Bill 685.

I would like to briefly mention a few of the safeguards contained in the bill in insure that its objectives are met as efficiently as possible. First, the tax credits will obviously not be taken until the private sector commits some capital to these capital companies. Passage of this bill does not automatically mean foregone revenue; the private sector must act first. In addition, this foregone revenue is being leveraged 4:1 in the private sector and invested in Montana businesses, which will generate job and tax revenues to the state. Second, there is a ceiling of $1,000,000 this biennium on the total tax credits available. I frankly do not think more than half of these credits may be utilized because of the difficulty of raising this kind of money. Third, the monies raised under this act must be put to use in Montana within a specific and reasonable time frame. They cannot remain invested in high yielding treasury bills in order to simply generate funds to pay the investment companies overhead. Finally, there is an annual examination of the companies by the states bank examiners to insure compliance with this act, and a specific penalty and decertification process for out of compliance companies.

EXHIBIT H.

In addition, I have some amendments which clarify language in the bill and allow it to more efficiently meet its policy objectives. These amendments are attached, and I urge that you carefully consider them.

Thank you.

DEVELOPMENT CREDIT CORPORATION OF MONTANA

P. O. BOX 916
HELENA, MONTANA 59601

TELEPHONE
442-3850

Proposed Amendments to House Bill 685

Page 2, line 24

Strike: "businesses"
Insert: "capital companies"

- clarification

Page 3, lines 6-7

Strike: "which gives priority to investments in the order of time in which they are committed"
Insert: "requiring investments within a specific period of time"

- clarification

Page 5, lines 4-25

Strike: All
Insert: "(5) Qualified investment means a debt or equity financing of, or purchase and leaseback financing of a Montana small business, as defined in rules adopted by the department, but does not include investment in conventional oil and gas exploration, residential real estate development, the operations of a regulated lender as defined in 31-1-111, or retail trade activities directly competitive with another Montana small business."

- I feel it is more direct and simpler to refer to what is excluded, rather than what is included. This is the language adopted by the committee, with the exception of the reference to retail trade. In addition, the language in the bill does not include a reference to tourism or construction, and sections (vii) and (viii) would be impossible to enforce or verify.

Page 6, lines 9-10

Strike: "March 1, 1984"
Insert: "September 1, 1983"

- I do not see why we should have to wait <u>one year</u> to put this bill to work. Our company is prepared to raise new capital as soon as possible, and the needs in our business community exist now. September 1, 1983, would allow the department four full months to adopt rules to implement the act. Companies potentially eligible for certification should not have to wait any longer than this to apply for certification.

Page 7, lines 9-14

Strike: "Every 6 months, commencing 6 months after the first date in which the department certifies a Montana capital company"

- After capital companies are certified, they should be able to file for qualification as soon as they raise the minimum capital. There is no reason to have to wait six months.

Page 7, lines 19-21

Strike: "The application . . . assessed under (Section 7(4))."

- It will simply be impossible to get bonded under conditions where there is no similar historical experience for a bonding company and little, if any, track record for the company seeking the bond.

Page 7, lines 23-24

Strike: "the company's private capitalization or $375,000, whichever is less."
Insert: "$375,000."

- I do not understand what this means. The tax credits are tentatively allocated at the time of certification. Of course, the amount allocated cannot be exceeded, and obviously will be reduced if the capitalization raised is less than expected.

Page 10, lines 8-9

Strike: "tax credits were certified as allocated to the company for investments."
Insert: "the certified company was designated as a qualified capital company by the department."

- clarification

Page 10, lines 11-12

same as above

- clarification

Page 10, lines 14-15

same as above

- clarification

Page 10, lines 21-22

Strike: "shall pay to the department of revenue"
Insert: "may be subject to"

- There should be flexibility when assessing the penalty, to allow for best and good faith efforts at investing the money or, to the contrary, minimal or no effort. An automatic penalty may result in poor investment decisions.

Page 11, lines 1-3

Strike: "The department of revenue shall deposit any amount received under this subsection to the credit of the state general fund."
Insert: "The departments of commerce and revenue shall jointly negotiate the penalty, and the department of revenue shall deposit any amount received under this subsection to the credit of the state general fund."

- same as above

Page 12, line 2

Strike: "capital base of"
Insert: "investments made by"

- In the act, capital base is defined as the equity of the company. The existing language would tie the company's investments to the equity base, which is inappropriate since a capital company can, through leverage, make total investments equal to 10-20 times its equity base. The amendment clarifies this point, and achieves the objective that we do not have single project capital companies.

Page 12, line 3

Strike: "invested"

- same as above

Page 14, line 22

Strike: "either" and "or qualified"

- The existing language seems to require two full disclosures. Since the critical point for raising money is certification and tentative approval for an amount of tax credits, evidence of full disclosure need only be required at the application for certification.

Page 14, line 24

Strike: "has disclosed or"

- same as above

Page 15, lines 6-8

Strike: all

Insert: "(2) that the tax credit will not be made available until the company raises at least $200,000 in capital, and the limits on tax credits that may be authorized."

- The existing language implies that there may be reasons for a certified company not getting qualified other than not simply raising $200,000. To avoid potential liability when soliciting investors, the capital company must be absolutely specific during fund raising about what conditions must be met to get qualified, and receive the tax credits. All requirements, except the minimum capitalization of $200,000, should be clear and met when the company is certified. The minimum capitalization should be the only issue left affecting the ability of a certified company to get qualified.

MONTANA CHAMBER OF COMMERCE
P. O. BOX 1730 • HELENA, MONTANA 59624 • PHONE 442-2405

Testimony
before the
Select Committee on Economic Development
John Vincent, Chairman
in support of
HB 685
by
Janelle K. Fallan
Public Affairs Manager
Montana Chamber of Commerce

February 10, 1983

The Private Industry Council, in which the Montana Chamber was actively involved, contracted for a study that determined there definitely is a need for such capital in Montana. That need would be addressed by HB 685.

Traditional financing sources do not meet small businesses' needs for equity financing. The basic capital availability problem for developing businesses is of great importance for the economic development in Montana.

Of all the programs in the Governor's Build Montana package, the portion dealing with capital companies is the only part that seeks to provide the venture and risk capital needed for meaningful economic development in Montana.

The Montana Chamber has a long record of concern about this issue. Three years ago, we formed a venture capital committee to work on it. The result was the SBIC bill of last session. However, that does not provide the necessary tax credit.

EXHIBIT I.

Last month, we invited Larry MacDonald from the Wyoming Industrial Development Corporation to address legislators and other interested citizens on this issue. He noted that one problem with attracting venture capital to Montana is our remote location. Another is our income tax, because many of the states that venture capitalists deal in do not have an income tax. For both these reasons, the income tax credit is important to attract venture capital to our state.

We urge your support of this bill.

/ssg

MONTANA STATE AFL-CIO
APRIL 29 1956

Box 1176, Helena, Montana

JAMES W. MURRY
EXECUTIVE SECRETARY

ZIP CODE 59624
406/442-1708

TESTIMONY OF DONALD R. JUDGE, ON HOUSE BILL 685, BEFORE THE SELECT COMMITTEE ON ECONOMIC DEVELOPMENT, FEBRUARY 10, 1983

Mr. Chairman, members of the Committee, my name is Don Judge and I'm here today representing the Montana State AFL-CIO in support of House Bill 685. Although we received our copy of House Bill 685 today, which didn't leave much time to properly prepare for this hearing, I think that I understand it, perhaps even better than any of the other bills we've testified on before this committee.

House Bill 685 is, simply put, a tax credit bill. As a simple example, and please correct me if I'm wrong; If I, as a taxpayer expecting to owe $1,000 in taxes, subsequently invested $4,000 in a certified capital company eligible for investment credit, I could apply 25% of my investment to wipe out my tax liability. That's a simple example, I realize, but beyond all the miscellaneous language contained in this bill, that's what it does.

Now even though this bill contains no provisions for matching money from the state, as originally proposed, I believe that this legislature still has some ownership over the "targeting" of "qualified" investments, because of the tax credit provisions. Because these provisions reflect a credit for liability of money owed the state, it is my assumption that state money is still involved here.

Assuming that I am correct, and that the legislature still has the ability to provide "targeting" goals for "qualified" investments, I am going to suggest a few amendments. They are as follows:

(1) Amend page 3, line 20

EXHIBIT J.

Following: "for employment"

Insert: <u>of Montanans</u>

(2) Amend page 3, line 25

Following: "small business"

Insert: at least 60% of whose operations are

(3) Amend page 5, line 6

Following: "that meets"

Strike: "both of"

(4) Amend page 6, line 2

Following: "rules adopted by the department."

Insert: a new subsection (c) to read as follows:

(c) priority shall be given to selection of qualified investments which:

(i) are made in counties or groups of counties designated as "critical economic areas" by the Montana Economic Development Board. Such areas will be prioritized as areas which (a) have had unemployment rates at least 5% above the state average for the last two years; (b) have had unemployment rates at least 1% above the state average for the last two years; and (c) have had unemployment rates at least 1% above the state average for the last one year;

(ii) pay the prevailing wage for that occupation, or utilize contractors who pay the prevailing wage, for any construction made possible by state investment;

(iii) meet or exceed the state standards for affirmative action in hiring veterans, women, minorities, and the handicapped.

Mr. Chairman, members of the Committee, I ask that you consider these amendments in your deliberations.

The last comments I wish to make regarding House Bill 685 concern the makeup

of the "board" referred to in Section 18. Let me echo our comments made on the composition of the Board in the hearing on House Bill 100. We simply encourage you to consider establishing criteria that the Board be primarily composed of members of the public and include a representative of organized labor.

With those thoughts, we ask you to support House Bill 685. Thank you.

HB 685

Presented to the House Select Committee on Economic Development
By the Montana Environmental Information Center

February 10, 1983

HB 685 is a fairly significant departure from the other bills considered by this committee. For starters, HB 685 does not directly invest any state held funds. Rather, it uses tax credits to stimulate private investment.

HB 685 is quite different from the Montana Capital Corporations bill suggested by the Temporary Committee on Development Finance. The committee's bill would have provided a 50 percent tax credit, not a 25 percent credit. The committee's bill would have provided state funds to match the capitalization of the MCC's. In that sense, the committee's bill represented more of a joint public/private venture than does HB 685. Finally, the list of "qualified investments" in the committee's bill was couched in terms of business types excluded, not in terms of eligible businesses.

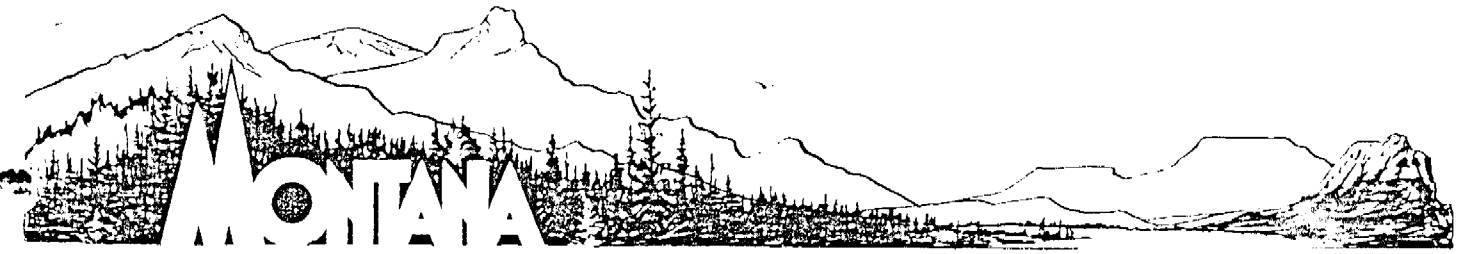
As I read through HB 685, I was surprised that all of the administraive functions were to be done by the Department of Commerce and not the Economic Development Board. Section 18 finally set me straight by pointing out that if the Board is created by HB 100, then the Board will be responsible, not the Department of Commerce.

We would like to make a suggestion to the committee regarding the Economic Development Board. General citizen representation will be essential to the success and fairness of the development finance programs. The composition of the Board is one place to ensure such representation. An additional possibility is to form several regional boards to advise the main Board. This would provide a more direct link between the diverse communities in Montana and the Board. This kind of grassroots involvement would strengthen the long-term ability of the Board to meet the economic development needs and desires of all Montanans.

The list of "qualified investments" (pp. 5-6, starting at line 4) is different than the approach suggested by the temporay committee. MEIC strongly supports "(ii) agricultural, fishery, or forestry production and processing;" "(iv) recognized nonfossil forms of energy generation as defined in 15-32-102(5);" "(vii) wholesale and retail distribution activities for which products produced in Montana comprise 50% or more of the gross sales receeipts;" and "(viii) any activity conducted in the state for which 50% or more of the gross receipts are derived from the sale of products or services outside Montana."

Finally, MEIC recommends that that the preferences in HB 100, as the select committee finally determines, be inserted in HB 385. The purpose is to carefully focus the program to maximize its ultimate

EXHIBIT K



ECONOMIC DEVELOPMENT ASSOCIATION
Post Office Box 1093 • Helena, Montana 59624 • February 10, 1983

TESTIMONY IN SUPPORT OF H.B. 685

The Montana Economic Development Association believes that the Capital Companies bill should be passed for two reasons:

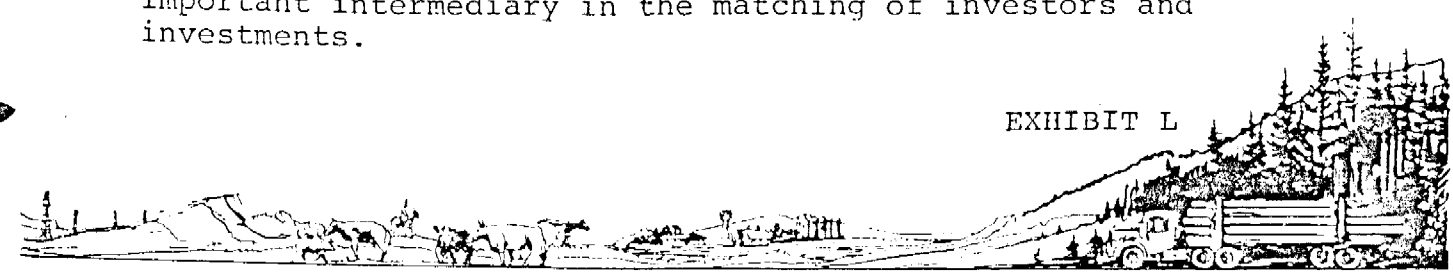
1. It would help fill a gap in financing resources in the state. Capital companies can be more versatile than conventional financing institutions in developing creative, appropriate solutions to a wide range of business/industry financing needs.

2. It represents a positive private sector response to a private sector problem, and it facilitates the investment of Montana capital in Montana.

Successful small businesses traditionally go through a series of phases to maturity. In its formational state, the business/industry is financed largely through the owners' personal savings and trade credit. Once it enters a period of substantial growth, however, it should be able to draw upon internal financing (retained earnings), trade credit, bank credit, and venture/equity capital. Unfortunately, the latter has not always been the case in Montana.

A growing small business in Montana may well have a hard time acquiring equity (or long-term debt) financing because it is not large enough to go public and individual private investors are difficult to find. The average small business owner does not know where to find a potential investor. He or she may place an ad in the Wall Street Journal or in another publication widely read by investors, but there is a certain randomness about that, and its productivity is questionable. On the other side of the desk, the individual investor may not have the time, the knowledge, or the desire to spend a great amount of effort evaluating the potential of the business, the soundness of its management, and the degree of financial risk involved. It is simply easier to put one's money elsewhere, in CDs or in structured funds which spread investors' risks over a number of investments. A Montana capital company could be a useful, important intermediary in the matching of investors and investments.

EXHIBIT L



The need for equity in a growing company is not a sign of weakness, but is a positive indication. At low growth rates a firm may need no external financing. For substantial growth, however, it must raise capital from outside sources -- the faster the growth rate, the greater the capital requirements. Particularly if a firm is capital intensive, even a small growth in output may require a great deal of outside capital. Technological considerations may also dictate that if a firm is to be competitive that it must add fixed assets in large, expensive units, where even a moderate increase in sales may require a firm to substantially increase its plant capacity.

Then, too, the availability of an equity base makes it easier and less expensive for a small firm to raise its debt capital. During periods of tight money and high interest rates, financial institutions may tighten their credit standards. A stronger balance sheet is required to qualify for bank credit. Since financial ratios for small and growing firms tend to be less strong, such firms often bear the brunt of credit restraints. Obviously if a firm has been able to raise some equity capital it is in a better position to ride out a tight money period. When it does need additional financing, its equity base enables it to present a stronger picture to the banks, thus helping it obtain further financing in the form of debt.

Small businesses generally are managed by their owners -- who are also responsible for overseeing production, negotiating sales, developing new products, training personnel, and a hundred other duties. Working 70-80 hour weeks, these individuals do not have the luxury of time to work on creative financial solutions to their capital problems. A capital company could be a valuable resource, providing both financial and management counseling and assistance.

For these and for many other reasons which have been enumerated by the other proponents of this measure, we endorse H.B. 685 and respectfully urge your favorable consideration of it.

Lauderdale, Pres.
MEDA

WOMEN'S LOBBYIST FUND

Box 1099
Helena, MT 59624
449-7917

February 10, 1983

TESTIMONY OF STACY A. FLAHERTY, WOMEN'S LOBBYIST FUND, BEFORE THE HOUSE SELECT COMMITTEE ON ECONOMIC DEVELOPMENT, CONCERNING HOUSE BILL 685.

The Women's Lobbyist Fund would like to make several comments about HB 685. Because of the problems that women have traditionally had in obtaining credit, this bill is particularly important in making credit available for businesses owned and operated by women. In this interest we would recommend adding to the aims of this bill on page 4, line 4

"including businesses owned and operated by non-traditional owners."

HB 685 is designed to make credit available to interests which have been disadvantaged in the traditional credit market--as the bill states to businesses for which risk and equity financing are not readily or fully available. Businesses owned and operated by women and minorities, i.e. non-traditional, are severely disadvantaged in obtaining credit. They frequently do not have long credit histories, initial cash balances, and the number of employees traditionally required on the credit market.

We also believe that this committee should consider moving the section of preferences from HB 100 (as amended to include the preference many of us mentioned last week to give preference to firms with demonstrable affirmative action programs) to HB 685.

While the capital corporations reflect private money collected through governmental policy rather than actual state money, we believe this same committment to policy direction would be appropriate throughout the Build Montana and economic development package.

Finally, a real way of expressing our preference for economic development is to reflect those policy directives through the composition of the Economic Development Board. Certainly, we believe that a sensitivity to, knowledge of, and attention to the role of women in economic development would best be ensured through having women in Montana businesses on that board.

We believe that in the course of discussing all of these bills additional attention needs to be paid to the composition of the Economic Development Board.

EXHIBIT M

Kathy A. van Hook, President
Sib Clack, Vice President
Connie Flaherty-Erickson, Treasurer
Celinda C. Lake, Lobbyist
Stacy A. Flaherty, Lobbyist

NOTES REFLECTING TESTIMONY BY DAN BUCKS, DEPT. OF REVENUE, ON HB 685

1. The bill would be a tax credit that is likely to succeed because it is targeted to a very specific purpose -- the creation of venture capital companies.

2. The definition of "qualified investments" in section 4 of the bill is very important. The definition helps insure that venture capital will be focused on small businesses that operate in basic, growth-producing sectors of the economy. Growth-producing activities are those that earn new export dollars for the state or that substitute in-state products or services for imports. The economic activities described in the definition are those that are most likely to produce new economic growth for the state. The alternative approach of leaving investments open to anything except certain activities does not guarantee the Legislature that the financing is focused on basic, growth-producing economic activities. Further, the approach in the original version of the bill establishes clear legislative policies for this program.

3. The certification start-up date of March 1, 1984 was specified to allow for adequate time for rule-making by the Dept. of Commerce or the new Economic Development Board and for adequate time, subsequent to rule-making, for private sector groups to decide whether or not to develop venture capital companies.

4. The penalty in section 10, subsection 4 of the bill is important to insure that capital companies make investments in the activities specified in the bill. Without an effective penalty, there is no guarantee that the tax credits will be used to achieve the intended purpose. The bond required in section 6 was included to insure that a repayment of the tax credits would occur in the case of a failure of a venture capital company. If a bond is unworkable, some other mechanism should be included to guarantee repayment of the tax credits in such cases.

5. The quarterly reports were specified in section 8 of the bill for two purposes. First, they are necessary to facilitate the timely granting of tax credits in the case of fiscal year taxpayers. An annual report would not timely enough to allow the Dept. of Revenue to verify, and therefore promptly approve tax credits, in the case of taxpayers who file returns on a fiscal year basis. Second, because the tax credit is relatively large, it could invite some fraudulent returns. The Dept. of Revenue wants to be able to verify credit claims quickly to avoid granting a fraudulent claim.

DISPOSITION OF HOUSE BILL 685

HARPER moved proposed amendments by Development Credit Corporation:

(1) Page 2, line 24
Following: "Montana"
Strike: "businesses"
Insert: "capital companies"

(2) Page 3, line 6
Following: "investments"
Strike: remainder of line 6 through "committed" on line 7
Insert: "if capital companies in the order in which they are qualified"

Motion carried. VINCENT, NEUMAN and SCHYE voted against.

HARPER made point that tourism is not covered under "qualified investment" and moved the following amendment:

(1) Page 6, line 1
Following: "page 5
Insert: "(ix) tourism; and"

Motion carried unanimously.

HARPER moved proposed amendment by Development Credit Corporation:

(1) Page 6, lines 9 and 10
Following: "commencing"
Strike: "March"
Insert: "January".

Gary Buchanan spoke against the motion saying his department needed more time to establish rules for certification of Montana capital companies. HARPER withdrew his motion.

FAGG moved proposed amendment by Department of Revenue:

(1) Page 11, line 1
Following: "company."
Insert: "The department of revenue may abate the penalty if the capital company establishes reasonable cause for the failure to make qualified investments pursuant to subsection (2) and the failure was not due to neglect on the part of the company."

Motion carried. NEUMAN voted against.

RAMIREZ moved proposed amendment by Women's Lobbyist Fund:

(1) Page 4, line 4
Following: "sources"
Insert: ", including those owned and operated by

women and minorities"

Motion carried unanimously.

The second proposed amendment by the Women's Lobbyist Fund requested addition of section of preferences from House Bill 100 to give preference to firms with demonstrable affirmative action programs. It was decided this was not necessary to include in this bill.

HARPER moved amendments proposed by AFL-CIO:

(1) Page 3, line 20
Following: "employment"
Insert: "of Montanans"

(2) Page 3, line 25
Following: "businesses"
Insert: ", at least 60% of whose facilities and personnel are"

Motion carried unanimously.

METCALF moved House Bill 685, AS AMENDED, DO PASS.

Motion carried unanimously.

METCALF moved Statement of Intent to be attached to House Bill 685.

Motion carried unanimously.

John Vincent

JOHN VINCENT, CHAIRMAN

joyce andrus

JOYCE ANDRUS, SECRETARY

WE, YOUR SELECT COMMITTEE ON ECONOMIC DEVELOPMENT, ATTACH TO HOUSE BILL 685, THE FOLLOWING:

STATEMENT OF INTENT

HOUSE BILL 685

A Statement of Intent is required for House Bill 685 because it grants rulemaking authority to the Department of Commerce to implement the act.

It is the intention of the legislature that the tax credits herein provided be applied only in the case of properly qualified investments. It is therefore the intention of the legislature that the department of Commerce, in making rules to define a small business, use whatever means necessary to arrive at a definition of small business which takes into account the unique nature of Montana small business. It is similarly the intention of the legislature that in the development of rules for certification and qualification of capital companies, the department shall take into account the capital needs of the state based upon such information made available to it on its own initiative and through such hearings as are necessary to achieve the purposes of the act. It is further the intention of the legislature that in determining such rules as are necessary to carry out the examination functions of the act, the department shall take into account commonly accepted principals of financial institution examinations currently

48TH LEGISLATURE

in use in the examination of banks and other such institutions. It is further the intention of the legislature that the rules authorized in the act be adopted in a timely fashion.

2/21/83

-END-

STANDING COMMITTEE REPORT

February 21 19 83

MR. Speaker

We, your committee on Select Economic Development

having had under consideration House Bil Bill No. 685

first reading copy (white color)

A BILL FOR AN ACT ENTITLED: "AN ACT PROMOTING THE AVAILABILITY AND INVESTMENT OF DEVELOPMENT CAPITAL IN MONTANA THROUGH THE CREATION OF CAPITAL COMPANIES; PROVIDING TAX CREDITS FOR INVESTMENT IN THE COMPANIES; PROVIDING OVERSIGHT AND AUDITING REQUIREMENTS; PROVIDING THAT OFFERINGS OF THE COMPANIES ARE EXEMPT FROM SECURITIES REGISTRATION; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE."

Respectfully report as follows: That House Bill No. 685

BE AMENDED AS FOLLOWS:

(1) Page 2, line 24
Following: "Montana"
Strike: "businesses"
Insert: "capital companies"

(2) Page 3, line 6
Following: "investments"
Strike: remainder of line 6 through "committed" on line 7
Insert: "if capital companies in the order in which they are qualified"

(3) Page 3, line 20
Following: "employment"
Insert: "of Montanans"

(4)

XXXXXX
DO PASS

Chairman.

STATE PUB. CO.
Helena, Mont.

COMMITTEE SECRETARY

(4) Page 3, line 25
Following: "businesses"
Insert: ", at least 60 percent of whose facilities and personnel are"

(5) Page 4, line 4
Following: "sources"
Insert: ", including those owned and operated by women and minorities"

(6) Page 5, line 22
Strike: "and"

(7) Page 6, line 1
Following: page 5
Insert: "(ix) tourism; and"

(8) Page 7, line 9
Following: "(1)"
Strike: remainder of line 9 through "the" on line 11
Insert: "The"

(9) Page 7, line 19
Following: "requires."
Strike: remainder of line 19 through line 21 in their entirety

(10) Page 7, line 23
Following: "exceed"
Strike: remainder of line 23 through "or" on line 24

(11) Page 7, line 24
Following: "$375,000"
Strike: ", whichever is less"

(12) Page 10, line 8
Following: "which"
Strike: remainder of line 8 through "investment" on line 9
Insert: "the certified company was designated as a qualified capital company by the department "

(13) Page 10, line 11
Following: "which"
Strike: remainder of line 11 through "investment" on line 12
Insert: "the certified company was designated as a qualified capital company by the department"

(14) Page 10, line 14
Following: "which"
Strike: remainder of line 14 through "investment" on line 15
Insert: "the certified company was designated as a qualified capital company by the department"

Chairman.

STATE PUB. CO.
Helena, Mont.

(15) Page 11, line 1
Following: "company."
Insert: "The department of revenue may abate the penalty if the capital company establishes reasonable cause for the failure to make qualified investments pursuant to subsection (2) and that the failure was not due to neglect on the part of the company."

(16) Page 12, line 2
Following: "the"
Strike: "capital base of a Montana capital company"
Insert: "equity raised by a Montana capital company under this act "

(17) Page 13, line 22
Following: "it."
Insert: "In the event of liquidation of the assets, any penalty imposed pursuant to section 7 of this act shall be included in the claims to be paid."

(18) Page 15, line 6
Following: "(2)"
Strike: remainder of line 6 through line 7 in their entirety
Insert: "the condition that a tax credit will not be made available until the company raises at least $200,000 in capital, and has been designated a qualified capital company,"

AND AS AMENDED
DO PASS

STATEMENT OF INTENT ATTACHED

Chairman.

STATE PUB. CO.
Helena, Mont.

48th LEGISLATIVE SESSION

COMMITTEE ON BUSINESS AND INDUSTRY

HOUSE BILL NO.	ENTERED COMM.	DATE CONSIDERED	OUT OF COMM.	DO PASS DATE	DO NOT PASS DATE	DO PASS AS AMEND. DATE	BE CONCURRED IN DATE	BE CONC. IN AS AMENDED DATE	BE NOT CONCURRED IN DATE
HB 638	3-1-83	3-10-83 3-16-83	3-16-83				3-16-83		
HB 655	3-1-83	3-15-83	3-15-83				3-15-83		
HB 670	3-1-83	3-14-83	3-14-83				3-14-83		
HB 685	3-2-83	3-10-83 ~~3-21-83~~	3-21-83					3-21-83	
HB 696	3-2-83	3-14-83	3-14-83				3-14-83		
HB 700	3-19-83 3-21-83	3-21-83						3-21-83	
HB 701	3-2-83	3-14-83 3-19-83	3-19-83					3-19-83	
HB 710	3-1-83	3-15-83 3-19-83	3-19-83				3-19-83		
HB 814	3-1-83	3-23-83	3-23-83					3-23-83	
HB 818	3-2-83	3-19-83 3-24-83	3-24-83				3-24-83		
HB 853	3-1-83	3-18-83 3-19-83	3-19-83					3-19-83	
RETURNED HB 853	3-24-83	3-24-83	3-24-83					3-24-83	
HB 871	3-1-83	3-21-83 3-24-83	3-24-83					3-24-83	
HB 886	3-2-83	3-23-83	3-23-83					3-23-83	

Use a separate sheet for Senate, House Bills, and Resolutions.

that was worked out with the various insurance companies. In the Business and Industry Committee in the House this went through three subcommittees and she hoped we would concur with the House vote.

The hearing was closed on House Bill 638.

CONSIDERATION OF HOUSE BILL 685: An act promoting the availability and investment of development capital in Montana through the creation of capital companies; providing tax credits for investment in the companies; providing oversight and auditing requirements; providing that offerings of the companies are exempt from securities registration; and providing an immediate effective date.

Representative Hal Harper stated you have all heard about the economic package coming from the House. This bill fits into that package with risk and equity capital. This bill is perhaps unique in that it does not provide any direct state financing it makes $1 million in tax credits available when the business community invests and puts money into these capital companies. This bill was drafted by the subcommittee on risk and venture capital. The bill has been amended to have the credits be provided on a first-come first-serve basis. A maximum of $375,000 per capital company is allowed. No general capital company is allowed. The language in the bill refers to the Department of Commerce.

PROPONENTS TO HOUSE BILL 685: Senator Fred Van Valkenburg went through the bill for the committee stating this $1 million cap is included within the million dollar proposed budget submitted by Governor Schwinden. He went into the mechanics of the bill stating the program starts by a group of investors coming in and proposing the creation of a qualified Montana company. After given authority to seek investors they go out and must raise a minimum of $200,000 before it can begin to take investments and those people can earn tax credits. The company must then make investments in certain kinds of businesses. The essence is in primary industry. They have also attempted to include the kind of retail businesses that have the affect of making primary jobs. The feeling in the economic community is similar to agriculture, mining, and other jobs that produce a multiplier effect. There are certain penalties for failure to meet investment requirements. The Department of Revenue can assess the taxes as if the tax credits had not been granted. This would come from the capital company. There is a restriction on investments. There are also certain recording requirements that the capital company must comply with. They must make quarterly reports and show how the investments are being made. This is to make sure there is no fraud. The tax credits themselves must be taken within four years. There is a provision for examination of capital companies. There is a procedure for decertification of the capital company. There is a prohibition of conflict of interest for the directors of the capital company to be involved in any of the investments that the capital company may make. There is rulemaking authority to the Department and there is a Statement of Intent to limit that rulemaking authority and finally there is a review by the Oversight Committee so that the Legislature remains involved in this.

Senator Tom Towe stated this bill is one of a package of four bills

that came out of the Development Finance Committee to set up I-95. It sets aside some of the coal tax trust for investment in Montana and secondly it sets aside a development income for various programs that are not loans but are advertising promotions. They decided we should not limit I-95 to use Montana's money in Montana but we should encourage money to come into Montana. When you talk about funding you have to talk about more than just loans and money that has to be repaid. A company cannot get that loan unless they have some equity or capital to start it going. This bill is an integral part of four bills that will be coming before us. Why is equity capital so important? Wherever you go for a loan the first thing they will ask about is a financial statement. If you don't have anything you will not likely get the loan. This bill brings in the equity capital. It is money that is not intended to be repaid as a loan but is an investment. The government is involved only to the extent that it is going to give tax credits of 25% to individuals. This allows us to encourage other private people to put equity money into these corporations. They then must invest in any venture that needs equity capital to get going.

Gary Buchanan, Department of Commerce, handed the committee two exhibits entitled "Montana Capital Companies Tax Credit" (Exhibit No. 4) and "Investing in America" (Exhibit No. 5). He stated this bill comes out of months of work from several people. He appointed a committee of about 58 people where they worked further on this concept. He mentioned in Wyoming, in cooperation with the local banks, they have created and preserved about 1400 jobs. This would allow Montana a variation of that effort to duplicate the Wyoming experience. The Department of Revenue has been assisting the proponents of the bill and the Department of Commerce on the revenue tax guides. The Committee on Financing recommended a 50% tax credit with a $3 million cap. They considered that and for revenue reasons they reduced it to $1 million cap and 25%. It is still adequate enough to provide for this kind of investment.

Dick Bourke, Vice President and Manager of Montana Development Credit Corporation, stated he had written testimony which he wanted to submit from Dick Remington. (Exhibit No. 6) He gave the committee a list of unsolicited contacts they have received about their need for money. (Exhibit No. 7) Many references were from banks in their area. There are a lot of people that need this kind of money. They are looking not only at just this but other types of ways to raise money. Venture capital is generally unavailable in Montana. He knows of one business that has been capitalized from an out-of-state but we do not have the kinds of business that they are interested in in Montana. Some people in the context of this bill will ask why do we need a tax credit? If you look at the provisions they have a half-dozen tax oriented incentives to put their money into. There are property tax credits, residential energy tax credits and others. His last point was that his perception of the bill is simply not foregone revenue, it is investment. This will be an investment the State can make through the private sector. He handed the committee an amendment which simply would change the date of commencement from March 1, 1984 to January 1, 1984. (Exhibit No. 8)

Representative Jay Fabrega stated he was one of the co-sponsors of this

concept in the 1981 session. He sponsored a similar bill which gave a 50% credit. Unfortunately, that did not go through. If it had we might have lower unemployment. He attended the Small Business Administration Advicates Conference and the hottest issue was the Massachusetts approach to revitalizing their capital base. They approached the Legislature asking for a reduction in the business tax. Instead of giving them the reduction of tax rate they would allow them to collectively develop a $100 million investment company and match it dollar for dollar with tax write offs. At this time, Massachusetts has the lowest unemployment rate of any industrial state. They have created all kinds of new companies. I hope the same experience will be here in Montana although we are going at 1/4 of the rate they had in Massachusetts. He can see where a lot of small investors may get into a $25 break. We are looking at a high risk situation. Also the fact that it has leverage in order to get 25¢ back you have to put up a dollar of your own and yet you may lose it.

John Scully, Montana Independent Bankers, stated they support this bill. They have had directors working on this and think it is a good bill.

Dave Goss, Billings Chamber of Commerce, stated working for the Chamber of Commerce they have people seeking advice and help on getting a new business started. Unfortunately, they have nothing but a good idea. The investment that will be made through this bill will be paid back many times.

Carol Daly, Montana Economic Development Association, stated she supports this bill. Her written testimony is attached to the minutes. (Exhibit No. 9)

Janelle Fallon, Montana Chamber of Commerce, stated there is a great need for venture capital in Montana. They see this as an important bill and they are pleased to support it.

Casey Armeston, Bozeman, stated their business is five years old. They started out as a small company but they now have eleven employees. They are still fighting the battle of equity capital. They nearly went bankrupt but they managed to find a few investors and they have now gotten their heads above water. It has taken them five years to get where they should have been in three years because they could not find equity capital. He feels this is the most important bill of the package and he supports it.

Jack Martin, Superior Fire Apparatus, stated on January 13th a meeting was called for small manufacturers which he attended. It was obvious the need for venture and risk capital to increase the tax base and increase employment. The economic development situation shows this. The time has passed when we can sit back and depend on the large out-of-state corporations to carry the ball for us. They must look to the people in Montana. During the meeting some statistics were brought out for example in 1981 Montana's manufacturers, exclusive of the lumber industry, contributed $400 million in salaries and wages, mining contributed $327 million and farming and agriculture was $251 million.

He has a company that is small and established. They have been on a pay as you go plan and have succeeded. He urged the committee's support for this type of legislation.

Mike Fitzgerald, Montana Trade Commission, stated he supported this bill. His written testimony is attached to the minutes. (Exhibit No. 10)

Celinda Lake, Women's Lobbyist Fund, stated she supports the bill. Her written testimony is attached to the minutes. (Exhibit No. 11)

Don Reed, MEIC, stated he supports this bill. His written testimony is attached to the minutes. (Exhibit No. 12)

Clint Grimes, Mountain Consultants, submitted written testimony in support of House Bill 685. His testimony is attached to the minutes. (Exhibit No. 13)

There were no further proponents and no opponents.

QUESTIONS FROM THE COMMITTEE: Senator Gage asked you indicated at this meeting you went to there was an indication that there was something like $400 million paid in wages and salaries and about 7,000 employees which comes to approximately $57,000 per employee. Mr. Martin stated that also includes income to the company.

Senator Dover asked on this lease back on page 5, I am wondering if this is going to be setting up leaseback companies where they would invest in companies? Senator Towe stated qualified investment companies will be the recipients of tax credit funds.

Senator Dover stated the Federal Government addressed that to where there was terrific comebacks on the lease back programs. Is that going to tie into that? Senator Towe stated it could.

Senator Dover stated farmers are looking at this all the time. If they can find someone to finance that or a leaseback program they can get large grain handling facilities. Senator Towe stated we are giving tax credits for people who invest in Company A, that being the feeder company. They are not going to need a tax write off until they make some money.

Senator Dover stated in section 12 "Examination" are you saying that the department and the bank examiners are encouraged to go to the bank? Senator Towe stated the examination function would be run out of the Department of Commerce. This sets up the procedures for the state and for other financial institutions.

Senator Goodover stated he would like to go on record as in favor of this concept. He has been a small business man all his life. He participated in many seminars. Over the years he has tried to expand small farm bills to include small businesses and this concept is in line with the activity he has been participating in to provide risk capital for the proper approach.

Senator Fuller asked would you be opposed to increasing that tax credit to 50%? Mr. Buchanan stated with the need to put a million dollar cap for budget reasons they wanted to spread the impact of this credit. He thinks it is still worth a try and depending on the success of this biennium maybe next session they can come back and raise it.

Senator Fuller asked what happened to the Montana bankers? Mr. Buchanan stated my feelings are they supported it from the beginning and that they support this bill now. Mr. Fitzgerald stated he spoke for Northwestern, Banco and First National and they support this bill. Mr. Bourke stated he talked with John Cadby, Montana Bankers Association, and stated he would try to be at the meeting, but that he supported this bill.

Senator Fuller asked once we have these capital corporations what do you anticipate will be the terms of this investment? Mr. Buchanan stated if we do equity investments we can buy conversion notes which the company might issue. This will give us authority to or we can simply buy stock in the company. For us to buy stock they need a strong capital base themselves. They will not see paybacks until five to seven years. They need to make those investments from our own capital base. This is a tool to increase their capital base. We can lend money if we so choose but if they lend money they are a point or two above the commercial rate.

Senator Lee stated he has a problem with the 25%. Basically you are doing the same thing with this bill that our society has done with the small businesses. We haven't made this available to them. Now we are trying to push this program and we will expect it to work on 25% investment credit. What are these other states using like Wyoming? Mr. Buchanan stated Wyoming does not have an income tax.

Senator Lee stated he would like to see 1987 stricken and work around that. If you allowed for two bienniums you could generate $8 million in investments. Mr. Buchanan stated we feel strongly about playing cautious in this situation.

Senator Lee stated it can be brought back next biennium. Senator Towe stated I think it is important to keep it in at some level and if we want to increase it at a later date we can.

Senator Lee asked on page 16, subsection 2, talks about a committee? Representative Harper stated House Bill 100 is the bill that establishes a committee. It is composed of seven members. We would direct the Governor to appoint them. If any of those bills pass they will assume the functions of that bill. Mr. Buchanan stated there is an Economic Development Board and an Oversight Committee. If those pass there will be set up an Oversight Committee.

Senator Kolstad asked do both bills have to pass in order to make this Oversight Committee active? Mr. Buchanan stated no, either one.

Senator Goodover stated on page 13, section 11, "legislative review

and oversight". This states they will report back. He wonders whether that should not be an annual but everyother year report. Senator Towe stated the committee can review the matter with an annual basis requirement.

Senator Goodover suggested the report should come from the committee that is appointed. The people responsible should be those who should report back to the Legislature. The Oversight Review Committee changes over a period of time.

Senator Boylan stated Montana is an island. We have not got transportation of getting goods in and out. The railroad won't pick up anything unless it is fifty car lots. I wonder if we are talking about a lot of "pie in the sky." It is interesting to talk with the gentleman in the House who wanted to manufacture calculators. He finally went to Hong Kong to do this. What type of industries are you talking about? Mr. Buchanan stated the people are mostly manufacturers - high tech or basic manufacturers.

Senator Christiaens asked what have we got to implement this for bringing in venture capital for equity? Do you have something planned to promote this? Mr. Buchanan stated they would charge for investments and seek investments and I can tell you there are a lot of people who are going to seek them. I think there is a demand in the state. They will agressively seek investments. Mr. Bourke stated I represent the Development Credit Corporation and they will go out to increase their capital to $1 1/2 million. They have 110 banks statewide. It is their feeling they have a good chance of raising a significant amount of capital should this bill pass. They support this bill. It is going to be pitched to everyone in the State. If we can end up with 3-5,000 shareholders in the State it is better for us. He is prepared to go out and make money. They feel it is a tool that will help make money in the private sector.

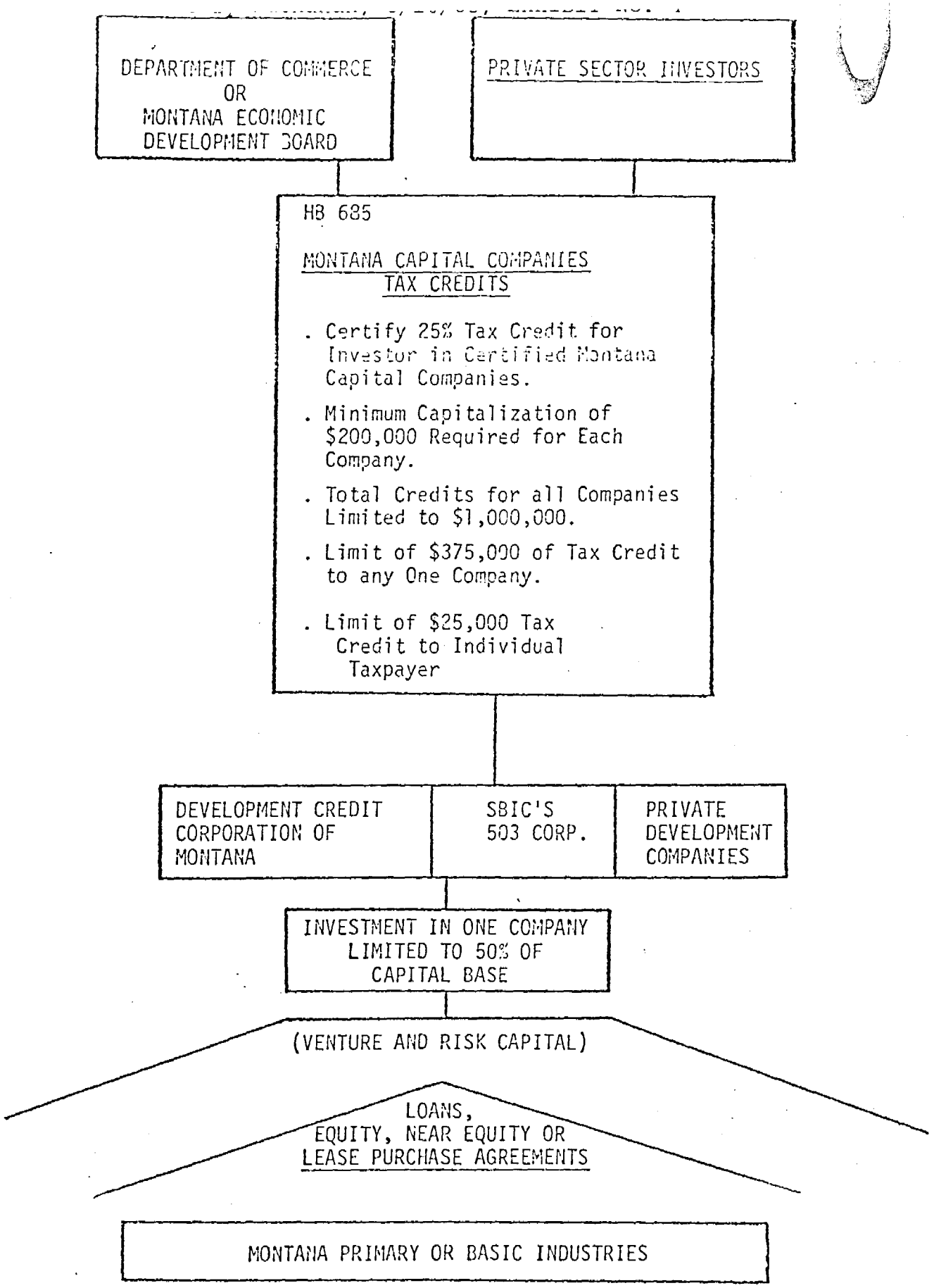
Senator Kolstad asked how long has it been since your company has been on an active basis? Mr. Bourke stated they have one active loan in Bozeman. We have repaid all loans. Right now they are looking at two investments.

Senator Kolstad asked have you done sufficient screening on these to be able to know how many of these would be possible loan risks? Mr. Bourke stated off hand he could take two out and the other eight he could look into further.

Senator Gage asked on page 5, under business engaged, line 11, I assume those kind of ventures were too risky to include in this kind of situation? Representative Harper stated yes.

Senator Gage asked how about unconventional? Representative Harper stated 1) you have to meet that criteria and 2) they have to be a small business as rules defined by the department.

The hearing was closed on House Bill 685.


DEPARTMENT OF COMMERCE
OR
MONTANA ECONOMIC
DEVELOPMENT BOARD
PRIVATE SECTOR INVESTORS
HB 685
MONTANA CAPITAL COMPANIES
TAX CREDITS
. Certify 25% Tax Credit for Investor in Certified Montana Capital Companies.
. Minimum Capitalization of $200,000 Required for Each Company.
. Total Credits for all Companies Limited to $1,000,000.
. Limit of $375,000 of Tax Credit to any One Company.
. Limit of $25,000 Tax Credit to Individual Taxpayer
DEVELOPMENT CREDIT CORPORATION OF MONTANA
SBIC'S 503 CORP.
PRIVATE DEVELOPMENT COMPANIES
INVESTMENT IN ONE COMPANY LIMITED TO 50% OF CAPITAL BASE
(VENTURE AND RISK CAPITAL)
LOANS,
EQUITY, NEAR EQUITY OR
LEASE PURCHASE AGREEMENTS
MONTANA PRIMARY OR BASIC INDUSTRIES

SCHEDULE

Effective Date of Act (Estimate)	March 31, 1981
Adoption of Rules to (Estimate) Implementation Act	April - November 30, 1981
Application Period	November 30 - April 31
Certification of Capital Companies	March 1, 1984 - And Every Six Months Thereafter
Designation of "Qualified" Capital Companies	September 1, 1984 - And Every Six Months Thereafter

OPERATION

30% Invested Within 3 years
50% Invested Within 4 years
70% Invested Within 5 years

QUARTERLY REPORTS

ANNUAL EXAMINATION

SUBMITTED BY: Gary Buchanan, 5/20/87

INVESTING IN AMERICA

INITIATIVES FOR COMMUNITY AND ECONOMIC DEVELOPMENT

The President's Task Force on Private Sector Initiatives

6 VENTURE CAPITAL

By The National Association of Small Business Investment Companies

Atari, Federal Express, Air Florida, Pizza Time Theatres, Kentucky Fried Chicken, Hospital Corporation of America, Digital Equipment and Apple Computer all have something special in common. In addition to being highly successful companies, the development of each was financed, in part, by venture capital dollars.

Perhaps no investment area profiled in this book is as dynamic today as venture capital. For a variety of reasons, the field is rapidly changing and expanding, developing innovative financing tools and broadening the scope of venture investing.

Traditionally, venture capital has referred to the money invested by professionals in a selected few small or embryonic businesses, in the hope they will grow and become very profitable. Such investments, by nature quite risky, can mean enormous payoffs for venture capitalists with shares in the earnings of companies that become highly successful.

This classic definition still applies, but only illustrates part of the picture of venture capital investing today. After a relative pausity of activity during the mid-1970s, venture investing is booming. New financing tools are being developed; more traditional ones are seeing a resurgence and being used in new ways. Innovative venture partnerships involving public as well as private participants are greatly expanding the role of venture capital in revitalizing distressed areas and industries. Even the parameters of what constitutes venture capital are expanding: at its broadest, it may today include the dollars invested by employees in the highly risky venture of buying a plant no longer considered profitable enough by the parent owners.

Two essential elements distinguish venture capital financing from other types of business investments. First, venture capital investments usually have strong equity features. Second, venture investors generally remain involved in the management and progress of the businesses they finance, sitting on the firms' boards, almost always as a minority shareholder, and providing counseling, often without cost. These

non-financial contributions are not a matter of charity; they are made because the venture capital investors will profit only if the companies grow.

Between 450 and 500 organized venture capital companies operate in the United States today, holding investments worth more than $6 billion. In addition to the organized and professionally managed venture capital funds--the subject of this chapter--there are hundreds of thousands of individuals who have made true "venture capital" investments—in the birth or growth of small family owned businesses, for example. No precise information can be collected on the magnitude of these informal venture capital flows. But it is important to mention this pool, because it is so critical in the formation of businesses and because government policies can impact heavily on capital formation through this mechanism.

Venture capital firms made record investments in 1981, some $1.4 billion in disbursements, compared with only $250 million in 1975 and $400 million in 1977. Some believe that the industry is growing so fast that there may actually be a shortage of experienced venture capitalists to manage the growing supply of available capital. But while the industry has more than doubled in size in the past five years, it still holds only a tiny percentage of the nation's capital. For comparison take pension funds, with close to $800 billion worth of investments in their portfolios. If pension fund managers were to invest just one percent of their assets in venture capital, the industry would more than double overnight. (Actually, as we shall examine later, many large capital sources, including pension funds and even foreign investors, are beginning to devote more of their assets to venture investments.)

Venture capitalists are highly selective, choosing for investment only a minute percentage of the funding requests they receive. The typical venture firm might review 200 to 300 proposed ventures annually, prepare a detailed analysis for 25 or 30, and fund five. Probably only one of those five will produce significant profits. Investors are looking for entrepreneurs who can develop a new or better product or service which has the potential to fill or create a niche in the market. They are seeking businesses with the potential to grow to a fairly large size rapidly. Key factors in making the investment decisions include technology, market, and business plan, and especially management talent. A cliche in the venture capital industry is that a company with a second rate idea and first rate management is a better investment risk than one with a first rate idea and second rate management. Among the skills the venture firm is looking for are unique technical know-how, a proven management track record, knowledge of manufacturing, marketing and finance, and a high level of commitment to the enterprise.

Since most firms receiving venture capital will not be highly successful, the venture capitalist hopes to make big profits on the 10 percent or so that are. Growth is extremely important. A critical milestone to the venture financier is the ability of a funded company to "go public": that is, to obtain further equity capital through the public sale of stock. Going public usually provides the venture investor the highest return on invested capital.

Since only a small percentage of venture funded firms actually go public, venture financiers have other means for "cashing out" their investments. The venture capitalist can sell shares in successful firms to other investors; some have even proposed creating a publicly supported secondary market to do so. Venture capitalists can cash out if a funded firm is bought by others or merged with another firm. Or the venture financier can negotiate a "put" with a funded firm—that is an agreement to sell the firm's stock or options back to the entrepreneur at some pre-determined multiple of earnings. Generally, "puts" are used when a debt financing instrument is involved. They are agreed upon at the beginning of the venture financing, but are not to be called in for at least five years, and ordinarily not until the funded firm has paid back its loan.

Although the pool of venture capital is small, many believe the industry's investments--because they are heavily weighted toward new technologies and job creating small enterprises—have a disproportionate impact on the nation's economy. The Government Accounting Office, in a 1982 report, Government Industry Cooperation Can Enhance the Venture Capital Process (GAO/AFMD-82-35, August 12, 1982), found: "...this small segment of the U.S. economy has produced disproportionately large benefits to the Nation's productivity and economic well-being." Venture capital funded firms had unusually high levels of productivity and job creation, GAO found in its evaluation of 1332 companies receiving $1.4 billion in venture investments during the 1970s. The $209 million in venture funds invested in 72 firms that eventually went public was ultimately responsible for an estimated 130,000 jobs, over $100 million in corporate tax revenues and $350 million in employee tax revenues, and $900 million in export sales, the report showed. In addition, GAO found, the products produced by venture capital funded firms tended to be productivity enhancing, contributing to the formation and development of new and economically promising industries. Other studies have tended to confirm GAO's conclusions.

Composition of Venture Capital Industry

Private venture capital firms supply about half of all the venture capital invested in enterprises. Most private venture capital firms are organized as limited partnerships. They are managed by a small team of

general partners and financed by limited partners, including pension funds, insurance companies, wealthy individuals and endowments, who invest funds to make up a capital pool. Some private venture capital firms are organized in corporate form; still others are the family funds--the Rockefeller, Whitney and Phipps, for example--which are managed professionally by outsiders. As a group, the estimated 130 private venture capital firms in the United States had committed about $3.3 billion in venture investments as of July 1982.

Sources of Funds

The following table details the major sources of capital committed to the private venture capital companies from 1980 through the first half of 1982.

CAPITAL COMMITMENTS
(Independent Private Firms Only)
(millions)

				Percent of Total Capital Committed		
	1980	1981	1982 (6 mos)	1980	1981	1982
Pensions Funds	$197	$200	$228	30%	23%	32%
Individuals/Families	102	201	115	16	23	16
Insurance Companies	88	132	112	13	15	16
Foreign	55	90	107	8	10	15
Corporations	127	142	90	19	17	13
Endowments/Foundations	92	102	54	14	12	8
TOTAL	$661	$867	$706			

Source: Venture Capital Journal, July 1982.

As the table shows, both pension funds and foreign investments have increased dramatically as a source of venture capital funds, more than equalling their 1981 total in only six months of 1982.

A second category of venture capital organizations are the Small Business Investment Companies (SBICs). Although licensed and regulated by SBA, their investments and management decisions are made on a completely private basis. There is one key distinction between SBICs and other private venture capital firms: SBICs can borrow from SBA (at an interest rate somewhat above the cost of money to the U.S. Treasury) and use these funds for further investments. Minority Enterprise Small Business Investment Companies (MESBICs) provide equity

and debt financing for firms owned by minorities and economically disadvantaged persons. Like SBICs, MESBICs can leverage private dollars with federal dollars creating a pool of capital several times the initial pool. SBICs vary dramatically in size. Many are owned by a relatively small group of local investors. Some are owned by corporations; 20 are publicly owned. Another 70 are owned partially or wholly by commercial banks. The nation's largest SBICs is Citicorp Venture Capital Limited, a subsidiary of Citicorp; it has over $37 million in private capital to invest. As of July 1982, there were 360 SBICs and 125 MESBICs in the United States. They had committed almost $2 billion to venture investments, financing about 1800 firms in 1981 alone.

The final type of organized venture capital firms are the corporate subsidiaries, divided into two categories: financial and industrial. The financial subsidiaries are owned primarily by banks; insurance companies, too, have formed venture capital subsidiaries. (Allstate's is one of the oldest and most successful). In the industrial sector are the venture capital firms owned by such companies as Exxon, General Electric, Xerox, Monsanto, and Emerson Electric. As of July, 1982, corporate venture capital firms had committed about $1.7 billion in investments.

Who Receives Venture Capital

Venture capitalists tend to seek out new technologies, new goods or new services to invest in, and not surprisingly, a large share of the venture capital investments today tend to be in high technology oriented businesses. But venture capitalists are not concerned solely with "growth industries:" they have also made good profits by pioneering investments in "growth companies" in non-high tech fields, or so-called "mundane" industries. Some of the most successful include nursing homes and health care companies, intrastate and regional airlines (Air Florida and Midway Airlines), cable television franchises, and commercial and financial services (Federal Express Corp. and Pandick Press).

The chart on the following page shows the distribution of venture capital investments by industry type during 1980 and 1981.

1981 Disbursements--Private Venture Capital Partnerships

	Percent of Total Number of Investments	
	1981	1980
Communications	11.4%	11.5%
Computer Related	30.0	27.4
Other Electronics Related	14.5	9.6
Genetic Engineering	6.2	4.2
Medical/Health Related	7.0	10.5
Energy	4.9	8.3
Consumer Related	4.9	7.5
Industrial Automation	6.2	4.5
Industrial Products	4.4	3.6
Other	10.5	12.9

Source: Venture Capital Journal, June 1982.

Venture Capital Financing

Venture capital is used for a wide variety of purposes: to develop the ideas for a product, to start businesses, expand them or prepare them for going public. There is no single way to structure venture capital financing. Venture capitalists often buy common stock in a business, exchanging capital for a "share" in the enterprise, usually taking a minority ownership position. Or they may purchase preferred stock, usually convertible into common stock, giving the financier a share of earnings before anyone else, but little or no voting rights. Another popular equity-type instrument in venture financing is convertible debt, where in addition to a commitment to interest and principal repayment (usually long-term), the enterprise gives the venture financier the right to convert debt notes into common stock. Subordinated long-term debentures are another common form of financing; in the event of default on this kind of loan, the lender is paid only after senior creditors, such as banks or commercial finance companies, who have prior claim on a firm's assets, are paid off. A venture firm may also assist a small business by guaranteeing loans or advances made by senior creditors. Most often, the venture capital financing is structured by using two or more of these instruments. In every case the format is different, designed to meet the specific needs of the business and the investor.

For the small firm, each type of financing has certain advantages. The sale of common stock strengthens the balance sheet of a growth firm, enabling it to borrow more from traditional lenders. But the entrepreneur must give up a larger share of the ownership of the business, than would be the case if some of the financing were in the form of debt. Preferred stock carries an obligation to pay dividends out

of after-tax income when the firm is profitable. Loans from venture capital firms are almost always long-term--seven years is the average for SBICs--and ordinarily subordinated to all other borrowings of the firm, to encourage senior creditors to extend and expand their line of credit.

One increasingly popular kind of venture arrangement is the "leveraged management buy out," where the management of a corporate subsidiary or division, together with an investor or investor group, purchases the subsidiary or division. The equity contributed by the investor and management purchasers is usually only 20 to 30 percent: the remainder is borrowed from banks and other institutions. The seller is usually a large corporation which has not achieved the benefits it expected when it either formed or bought the subsidiary or operation.

Financing Stages

Venture capital may be provided to firms at varying stages of development, each carrying different risks and payoffs for the financier. Early stage money, for example, may promise the greatest profits if the firm is successful, but also carries the most risk, requiring more hands on involvement for the venture firm and the possibility of open ended financial commitments.

The following chart shows the six financing stages for a developing business. These are not rigid or fixed, however. Venture capital can be used in any stage.

Early Stage:

Seed Financing—a relatively small amount of capital provided to an investor or entrepreneur to prove a concept. It may involve product development but rarely involves initial marketing. This kind of investment is sometimes referred to as "adventure financing."

Startup--financing for use in product development and initial marketing. Companies may be in the organization process or they may have been in business a short time (one year or less), but have not sold their product commercially. Usually, such firms would have assembled the key management, prepared a business plan, made market studies, and generally prepared themselves to do business.

First Stage Financing—financing provided to companies that have expended their initial capital (often in developing a prototype) and require funds to initiate commercial manufacturing and sales.

Expansion:

Second Stage Financing--working capital for the initial expansion of a company which is producing and shipping, and has growing accounts receivable and inventories. Although the company has clearly made progress, it may not yet be showing a profit.

Third Stage Financing--funds provided for major expansion of a company whose sales volume is increasing, and that is breaking even or profitable. These funds are utilized for further plant expansion, marketing, working capital or an improved product.

Fourth Stage (Bridge) Financing--financing for a company expecting to go public within six months to a year.

The venture capital industry has gone through several swings in its financing patterns. Seed and start-up financing flourished during the 1960s, when venture firms stressed new business creation over on-going development. That reversed in the mid-1970s, when start-ups fell to only 10 percent of venture financing; today, early stage financing is again being emphasized, accounting for 52 percent of the 1981 venture dollars invested.

SBICs, which must pay interest on their loans from SBA, tend to invest in enterprises that are slightly more established. Only about one third of the firms financed by SBICs in 1981 were start-ups, while more than 13 percent were over 10 years old. More than 60 percent of SBIC dollars, however, went to firms less than three years old. Two thirds of the dollars invested by SBICs were used by recipient firms for operating capital.

Origins of Organized Venture Capital

Throughout its history, the United States has depended on venture capital to fuel its economic growth. George Washington and many others provided the funds for digging canals and building roads and railroads; later the duPonts helped finance General Motors; Mellon dollars built Gulf Oil and Alcoa; the Rockefellers took some of their oil dollars to fund Eastern Airlines. Less dramatic are the hundreds of thousands of examples of relatively small investments by family members and friends in hometown success stories in all parts of the country.

As an organized industry, venture capital was not highly visible before 1946, when the American Research and Development Corp.

(AR&D) revolutionized the nature of venture investments. Family funds, such as those organized by the Rockefellers, the Whitneys, and the Phipps were operating, but without publicity, so the typical entrepreneur had no access to these sources of venture funding.

AR&D, organized by a group of New England business leaders and headed by Gen. Georges Doriot, a Harvard Business School professor, was formed solely for the purpose of making venture investments. It supplemented its initial private capital by several public offerings of its stock; the resulting capital pool was invested heavily in high technology companies. Like the venture capital firms of today, AR&D gave managerial assistance and technical advice to its portfolio firms. In 1957, AR&D added to its portfolio a $70,000 investment to start a firm called Digital Equipment. Digital Equipment experienced early financial problems. But as the company matured, its value increased until AR&D's initial venture investment had evolved into a holding worth more than $300 million. AR&D's experiences helped convince others of the profits to be made in venture investing.

The next milestone in the development of the venture capital industry was the 1958 Small Business Investment Act, which authorized the SBIC program. Also that year, Congress took several actions in the tax field which had the effect of promoting capital formation for smaller firms and assisting in the formation of new businesses. These included: permission for closely-held corporations to elect to be taxed as partnerships; authority for losses on investments in small businesses to be written off against ordinary income; and the beginning of a graduated tax rate on corporate income.

Many SBICs were organized during the 1960s, and in the late 1960s and early 1970s, a number of venture capital firms were formed, many as partnerships but some as corporations and others as subsidiaries of major firms. In 1969, the SBIC pattern was extended to minority firms with the establishment of the MESBIC program.

After the rapid growth of the industry in the 1960s, many SBICs and venture capital firms left the business in the mid 1970s, due in part to changes in federal tax and regulatory policies and the depressed state of the over-the-counter securities market. In 1978, the industry began to revive as rates of return for venture firms improved and as new tax and other federal policies provided greater incentives for venture investments.

During the venture capital industry's relatively short existence, the highly visible success stories of venture backed firms such as Apple Computer, Control Data, Teledyne, Intel, Amdahl, Federal Express and Cray Research have continued to encourage expansion. Today venture capital companies tend to be concentrated in six or eight major

metropolitan areas, including Boston, New York, Chicago, Minneapolis, Dallas, San Francisco and Los Angeles, although more geographic dispersion is occurring as new firms are established. The enterprises receiving venture investments also tend to be concentrated in a few states--California, Massachusetts, and New York, for example--where high technology firms are plentiful. Those three states accounted for 57 percent of the venture capital disbursements in 1981.

The Impacts of Federal Policy

Venture capital firms, depending on type, experience varying degrees of government regulation. SBICs and MESBICs are regulated by SBA; those that are publicly-owned are also regulated by the Securities and Exchange Commission, under either the Investment Company Act of 1940 or the Small Business Investment Incentive Act of 1980. Publicly-owned private venture capital firms are also regulated by SEC. The other segments of the venture capital community are free from any regulatory framework, but as is the case with all parts of the industry, must operate under federal and state securities laws.

Many students of the venture capital industry believe federal tax and regulatory policies have an important impact on the flow of venture capital to new enterprises. "The venture capital process is very sensitive to government policies, rules and regulations," concluded GAO in its comprehensive report. The Tax Acts of 1969 and 1976, which raised the federal tax rate on capital gains from 25 percent to 49 percent and altered the tax treatment of stock options, are frequently cited as contributing to the decline of venture investment activity in the 1970s, when disbursements dropped from nearly $500 million in 1969 to $250 million in 1975.

The federal actions may have had a ripple effect on venture financing and new enterprise formation, GAO concluded. With the perception of reduced capital availability, entrepreneurs became less inclined to pursue new business ventures. With stock options less attractive, experienced managers and technocrats became less inclined to abandon secure careers for entrepreneurial ventures. Venture capital firms tended to shift from start-ups to more short-term investments in existing businesses, and, GAO found, the number of venture firms declined.

The number of companies going public also declined significantly during the early 1970s, from an annual average of 721 from 1968 to 1972 to only 55 in 1974 and an average of 45 from 1975 to 1978. Some believe the federal tax laws and securities regulations were largely responsible for the decline in the number of new issues; others cite generally poor economic conditions during the 1973-1976 recession as the key factor. Whatever the cause, the poor securities market was an

impediment to venture financing.

In 1978 Congress cut the tax rate on capital gains back to 28 percent, and venture funding, which had been increasing slowly since the lowpoint in 1975, shot up dramatically, from around $400 million in disbursements in 1977 to $1 billion in 1979. Congress lowered the rate again in 1981, to a maximum of 20 percent, and reversed the changes in stock option provisions that had been enacted in 1976. Another government regulatory action cited as having a significant impact in encouraging venture financing was the decision by officials at the Labor Department to take a more liberal view of the "prudent man" requirements of the Employee Retirement Income Security Act of 1974, governing the investment of pension fund assets, to allow for some more "risky" investing.

CASE EXAMPLES

The Private Venture Capital Firm: Oxford Partners

Like most private venture capital companies, Oxford Partners operates as a limited partnership. Oxford Partners manages the Oxford Venture Fund, a $20 million capital pool, made up of investments from pension funds, corporations, wealthy individuals, insurance companies, bank trust departments, and others.

Oxford Partners began in June 1981. It now has nine investments in its portfolio, all high technology oriented companies, with names such as Aspech, Queue Systems, RF Monolithics, Faded J, and Micro General. Oxford generally makes equity investments, usually purchasing common or preferred stock. It stresses early stage financing.

Oxford Partners will only consider business plans submitted for financing. It receives somewhere around 50 funding requests per month, from which fewer than one percent are selected.

The SBIC: Northwest Growth Fund

Founded in 1961, this Minneapolis-based company has been one of the nation's largest and most successful SBICs, investing more than $65 million in 165 companies. In the late 1970s Northwest Growth purchased two other SBICs, in Portland and Denver. In 1979 it became a wholly-owned subsidiary of Northwest Bancorporation, the 18th largest bank holding company in the U.S.

As of mid-1981, Northwest Growth Fund held over 65 companies in its portfolio: many were in high technology, but the firm's investments are quite diverse, in such areas as machining, medical products and pharmeceuticals, chemical agriculture, education and computer assisted

design and manufacturing. The only kind of venture Northwest Growth will not invest in is real estate.

Between 1975 and 1980, the firm's net asset value grew at a compounded annual rate of over 50 percent. Firms funded by Northwest Growth employed 15,000.

For most of Northwest Growth's investments, the fund takes an equity position in its enterprises, using a combination of convertible debt securities and common and preferred stock. The fund also provides management assistance, and usually sits on its firms' boards of directors as a minority shareholder.

Revitalizing Distressed Areas: Kentucky Highlands Investment Corporation

Increasingly, venture capital financing tools are being used to stimulate economic activity in distressed communities. One excellent example is the Kentucky Highlands Investment Corporation, a community development corporation which has taken a venture capitalist approach to community and business development. KHIC supplies risk capital and management assistance to entrepreneurs wishing to start or expand businesses in a 12-county region of Eastern Kentucky, where per capita income is far below the national average and unemployment is high.

KHIC is nonprofit, but it has established two for-profit development subsidiaries: Mountain Ventures Inc., an SBIC, and Kentucky Highlands Real Estate Corporation, which has begun developing industrial properties.

KHIC tends to invest in manufacturing companies, generally low technology, labor intensive industries, but will also consider wholesaling and service ventures. KHIC uses many different types of financing arrangements, buying common or preferred stock, and issuing convertible and subordinated long-term loans. About two-thirds of its financing is in debt form. It also provides a wide range of management services.

Since 1971, KHIC has invested close to $5 million in 19 companies, employing nearly 500 area residents. Among KHIC supported ventures are Possom Trot Corporation in McKee, Ky., manufacturer of soft toys and tote bags, Outdoor Venture Corporation, producer of camping tents, and American Bag Co., producer of sleeping bags, in Pine Knot, Ky.

KHIC built its capital pool using a combination of public and private dollars. Initially it received federal funds primarily from the Community Services Administration, but since 1982 has been privately financed.

State Supported Venture Capital Funds

An increasing number of states are establishing venture capital type funds to help finance development within the state of new products or technologies, or to revitalize distressed communities.

+ The Connecticut Product Development Corporation, a quasi-public agency authorized by the Connecticut legislature in 1972, supplies equity capital to small enterprises within the state that wish to develop new products, expand production or diversify. In return for its investment, the CPDC receives a royalty on each product sold.

CPDC will fund up to 60 percent of the development costs of a new product: the company is expected to raise the remainder. CPDC funds may not be used for working capital or the purchase of land, equipment or buildings. If the product reaches the marketplace, CPDC receives a royalty of 5 percent of the sales until the grant has been repaid five times. One important advantage of CPDC's funding approach is that the payoff to the venture financier, in this case CPDC, depends only on the success of the product, not on the ability of the producing firm to go public or be acquired by another firm, as is normally the case in venture investing.

CPDC, modeled on the British National Research Development Corporation, established in 1948 to help speed post war recovery, was initially capitalized with $10 million in state bond funds. By June 30, 1982, the corporation had committed more than $5.3 million to 39 small firms and was collecting more than $500,000 annually in royalties. Among the 46 products financed to date are laser equipment to inspect newly manufactured machine parts, computer software packages, solar heating panels, a freezing technique to better preserve food flavors, computerized business telephones, bathroom scales and an electronic file cabinet.

+ Like CPDC, the Massachusetts Technology Development Corporation uses public venture financing to encourage the development of high technology companies. The corporation generally supplies seed capital in the form of subordinated debt.

Four criteria govern MTDC investments: the venture must have an innovative technology; it must have a reasonable chance of commercial success; private sector financing must be involved; and the investment should yield benefits to Massachusetts through by creating jobs and stimulating economic development.

+ Massachusetts and Louisiana are among a growing number of states which have established venture funds to stimulate economic activity in distressed areas. The Massachusetts Community Development

Finance Corporation was established in 1975 to make investments in community-based ventures in low-income areas across the state. The Louisiana Small Business Equity Corporation supplies financing for small firms that contribute to increased employment and economic activity in the state, that are owned by disadvantaged persons, or that invest in distressed areas. Recipient firms must show they are capable of providing at least $1 of private capital for every $4 they receive from the state.

Innovative Private Venture Capital Funds

+ The Massachusetts Capital Resource Company is a partnership of nine life insurance companies in Massachusetts which, in return for tax relief granted by the state, are providing venture capital to in-state businesses. MCRC is for-profit. Now capitalized at $100 million, it supplies four basic types of investments: long-term loans to companies unable to borrow from conventional sources, subordinated debt to rapidly growing firms, investments with others to revitalize existing businesses, and growth capital to young firms. MCRC will finance all sizes of businesses, but is prohibited from investing in real estate developers, retailers, construction companies, public utilities and most financial intermediaries.

By November 9, 1982, MCRC had invested over $81.5 million in 72 firms, with individual investments ranging from $100,000 to $5 million. Its earnings exceeded $5 million in 1981.

+ The Minnesota Seed Capital Fund was organized in 1980 by several Minnesota corporations as a for-profit venture to provide start up money, or so-called "angel funds," primarily for high technology companies in the state. Its initial corporate contributors included Control Data Corp., Dayton-Hudson Corp., Data Card Corp., Piper, Jaffray and Hopwood, Inc., Northern States Power Co., Carlson Cos. and the Minneapolis Star and Tribune Co. In 1982, two large pension funds announced their participation: Control Data pension fund committed $500,000, as did the public Minnesota Employees Retirement Fund (MERF).

The fund works closely with the Minnesota Cooperation Office, an independent, nonprofit organization formed by the business community to advise small firms. All potential recipients of Seed Capital investments must go first to the MCO, which is staffed by volunteer business professionals, to receive assistance in preparing a business plan. Once a firm receives an investment, however, the Seed Capital Fund, unlike some venture capital financiers, is not heavily involved in its management.

As of November, 1982, the Seed Capital Fund had $3.2 million in capital, of which $866,000 had been committed to seven firms. These

included Audiobionics, developer of computer aided systems for the deaf; Multi-Arc Vacuum Systems, Inc., a company specializing in increasing the durability of high speed machine tools; DataText Systems, Inc., a computer graphics company; Magnetic Data Inc., which helps refurbish magnetic disks for computers; and Mid-American International Trading Co., the Fund's only non-high technology investment, which assists small Minnesota businesses in marketing products worldwide.

The Seed Capital Fund's investments generally take the form of preferred or common stock, and to date have not exceeded $250,000 to any single company.

SUBMITTED BY: DICK BOURKE FOR DICK REMINGTON, 3/10/83, EXHIBIT NO. 6

DEVELOPMENT CREDIT CORPORATION OF MONTANA

P. O. BOX 916
HELENA, MONTANA 59601

TELEPHONE
442-3850

March 10, 1983; Senate Business and Industry Committee
Testimony in Support of House Bill 685

Mr. Chairman and members of the committee:

My name is Dick Remington and I am the Vice-President and Montana Manager for Mountain Bell, and the President of the Development Credit Corporation of Montana.

The Development Credit Corporation is a private, for-profit business development corporation chartered under Montana state law. Our shareholders are many of the state's financial institutions, a few large corporations operating in Montana, and half a dozen rural electric cooperatives. We have an existing capitalization of about $250,000, and are the only organized financial institution in Montana capable of providing risk and equity capital to worthy Montana businesses.

We enthusiastically support the passage of House Bill 685 as a well designed and thoughtful approach to providing incentives for the private sector to meet the risk and equity capital needs of Montana's small business community. As you may know, there exists a strong consensus among Montana's financial and business community that we lack access to venture capital, and that this is likely the most serious capital problem facing our small business people.

The Development Credit Corporation is in the business of providing risk and equity capital. In simple terms, this is capital which is not available from conventional financial institutions, due to either size or term requirements, level of risk or sufficiency of equity. For example, let's assume a business is being started which needs $500,000.

The local bank may lend up to $250,000, but the owners only have $50,000 in cash. The $200,000 gap in financing may be filled by what I refer to as risk or equity capital. Types of financings which fall in this category include subordinate or convertible debt, usually of a longer term nature, purchase of preferred or common stock in the business, or purchase and leaseback of real estate and equipment.

There has been little, if any, institutional capacity to supply this kind of capital in Montana. In 1981, only four percent of the venture capital investments made nationally were made in the entire eight state Rocky Mountain region. The national venture capital industry simply grew up where the money and deals existed, namely the east and west coasts, and Minneapolis area. Our remoteness from these areas, and perceived lack of high technology and high growth businesses has kept this source of funds from being made available to our business sector.

What does this have to do with HB 685? House Bill 685 simply establishes tax credits for investors in companies like the Development Credit Corporation. We need to offer potential investors this additional financial incentive in order to raise significant amounts of new capital which will allow us to aggressively pursue venture capital investing. In Montana, it is extremely difficult to raise capital for an in-state venture capital company, particularly when the return to the investors will not be realized for at least three years, and up to seven years.

Several important points must be remembered. First, out-of-state venture capitalists are not generally interested in Montana, for reasons mentioned above. Second, we must develop an in-state private sector institutional capability to supply risk and equity financing tailored to our unique economic environment. Third, our company needs a large capital base in order to vigorously pursue venture capital investing. This bill provides a critically needed incentive to spur investment from the private sector in capital companies such as ours, and I urge you to give it a do pass recommendation.

SUBMITTED BY: Dick Bourke, 3/10/83, EXHIBIT NO. 7

DEVELOPMENT CREDIT CORPORATION OF MONTANA

P. O. BOX 916
HELENA, MONTANA 59601

TELEPHONE
442-3850

Business/Individual Contacts Since 1/15/83

1. K & M Industries, Inc.
   Billings, Montana

2. Pintlar Manufacturing Corp.
   Anaconda, Montana

3. King Tool, Inc.
   Bozeman, Montana

4. Capital Courts & Health Club
   Helena, Montana

5. Bee Made Products Laboratories, Inc.
   Terry, Montana

6. CB & F Development Corp.
   Culbertson, Montana

7. Summit Products
   Bozeman, Montana

8. AE Montana
   Belgrade, Montana

9. Diversified Enterprises
   Kalispell, Montana

10. Montana Pole & Treating
    Butte, Montana

SUBMITTED BY: DICK BOURKE, 3/10/83, EXHIBIT NO. 3

DEVELOPMENT CREDIT CORPORATION OF MONTANA

P.O BOX 916
HELENA, MONTANA 59624

TELEPHONE
442-3850

To: Members of the Senate Business and Industry Committee

Fr: Dick Bourke, Vice-President

Re: Proposed Amendment to House Bill 685

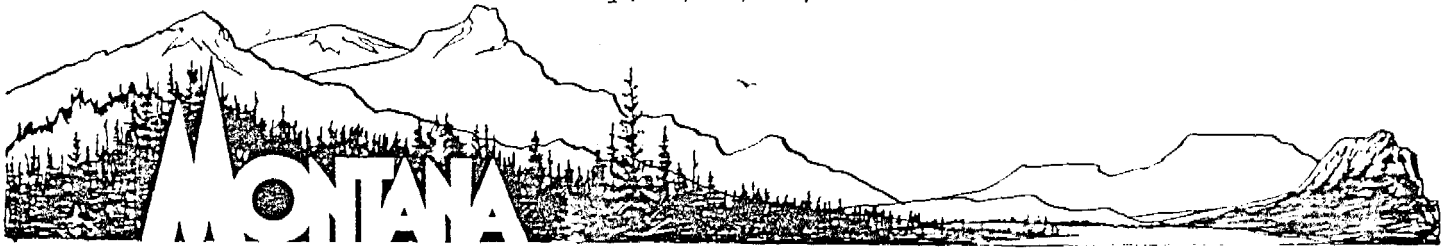
Page 6, line 14

Following: "commencing"

Strike: "March 1, 1984"

Insert: "January 1, 1984"

SUBMITTED BY: Carol Daly, 3/10/83, EXHIBIT NO. 9



ECONOMIC DEVELOPMENT ASSOCIATION
Post Office Box 1093 • Helena, Montana 59624 • March 10, 1983

TESTIMONY IN SUPPORT OF H.B. 685

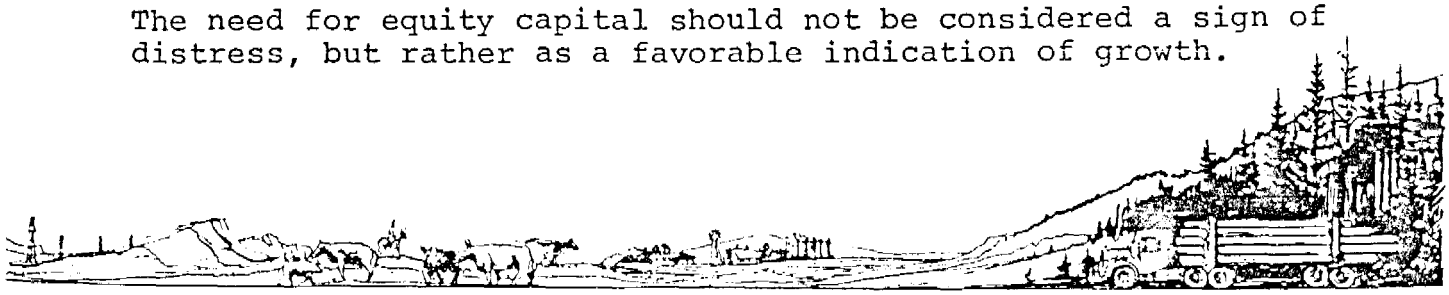
The Montana Economic Development Association supports the creation and/or expansion of capital companies in Montana because:

1. They represent a positive private sector response to a private sector problem;
2. They would encourage and facilitate the investment of Montana capital in the state;
3. They would help fill a void in the state's business financing structure; and
4. They can be more versatile than conventional financing institutions in developing and carrying out creative solutions to a wide range of business financing needs.

Successful small businesses traditionally go through a series of growth phases. In their formational state, the firm is financed largely through the owners' personal savings and trade credit, supplemented by occasional short term bank loans. Once the firm enters a period of substantial growth, the firm should be able to draw upon internal financing (from retained earnings), trade credit, bank credit, and venture capital. Unfortunately, this has not always been the case in Montana.

When a firm is in its growth state, it may well have a difficult time obtaining equity (or long term debt) financing because it is not large enough to go public and it may be unable to identify and reach individual private investors. Even if it is able to locate persons with investment resources, those individuals may not have the time or the knowledge to be able to evaluate the potential of the business, the soundness of its management, the viability of its markets, and other considerations which must be taken into account when making an investment decision. All too often this evaluation appears too complex or too costly or too time consuming to the unsophisticated investor, so he/she puts his/her money elsewhere, somewhere "safer", opting for the security of a blue chip investment such as IBM rather than for the possibility of a higher return on investment through putting the money in a growing Montana firm.

The need for equity capital should not be considered a sign of distress, but rather as a favorable indication of growth.



At low growth rates, a firm may need no external financing. For substantial growth, however, it must raise capital from outside sources -- the faster the growth rate, the greater the capital requirements. Particularly if a firm is capital intensive, even a small growth in output may require a great deal of outside capital. Technological considerations may also dictate that if the firm is to be competitive that it add fixed assets in large, discrete units, so that even a small increase in sales might require a firm to substantially increase its plant capacity.

The availability of an equity base makes it easier and less expensive for a small firm to raise its debt capital. During periods of tight money and high interest rates, financial institutions may tighten their credit standards to ration limited affordable capital supplies. A stronger balance sheet is required to qualify for bank credit. Since financial ratios for small and growing firms tend to be less strong, such firms bear the brunt of credit restraints. Obviously if the firm has raised some equity capital it is in a better position to ride out a tight money period. It has already raised some of its needed capital, and its equity cushion enables it to present a stronger picture to conventional finacing institutions, thus helping it obtain further financing in the form of debt.

Capital companies can of course also provide debt financing, leasebacks of equipment and facilities, lease purchase packages, and numerous other financing options. The availability of those resources are sorely needed by the Montana business community, and for that reason we urge your favorable consideration of HB 685.

Thank you.

Carol Daly
President

SUBMITTED BY: Mike Fitzgerald, 3/10/83, EXHIBIT NO. 10

(This sheet to be used by those testifying on a bill.)

NAME: Mike Fitzgerald DATE: 10 March 83

ADDRESS: Suite 612 Power Building

PHONE: 1113-7910

REPRESENTING WHOM? Montana Trade Commission

APPEARING ON WHICH PROPOSAL: # 3685

DO YOU: SUPPORT? ✓ AMEND? _____ OPPOSE? _____

COMMENT:

This is one of the only equity jobs initiatives before the Legislature.

It will create incentives to attract investors to develop a venture capital / Capital pool in Montana. There is little or no incentive or equity oriented in this field - This is the likelihood of new business - HB685 is important to create new business in Montana - Any tax revenue loss by the credit will be many times recouped by the investment in new businesses and jobs & payroll + personal income taxes.

PLEASE LEAVE ANY PREPARED STATEMENTS WITH THE COMMITTEE SECRETARY.

SUBMITTED BY: Celinda Lake, 3/10/95, EXHIBIT NO. 11

WOMEN'S LOBBYIST FUND

Box 1099
Helena, MT 59624
449-7917

Testimony of Celinda Lake, Women's Lobbyist Fund, in support of HB685 before Business and Industry

Mr. Chairman, the Women's Lobbyist Fund, supports HB685. We believe that it is an important tool for building Montana's economy on and our terms. HB685 is designed to help businesses which have been disadvantaged in the traditional capital market. Firms owned and operated by women certainly fit that category. The amendments added in the House will ensure that this state facilitated investment will occur in the spirit expressed by the public in their support of Initiative 95. We urge your support of HB685.

Kathy A. van Hook, President
Sib Clack, Vice President
Connie Flaherty-Erickson, Treasurer
Celinda C. Lake, Lobbyist
Stacy A. Flaherty, Lobbyist

HB 685

Presented to the Senate Committee on Business and Industry
By the Montana Environmental Information Center

March 10, 1983

HB 685 is a fairly significant departure from the other bills considered by this committee. For starters, HB 685 does not directly invest any state held funds. Rather, it uses tax credits to stimulate private investment.

HB 685 is quite different from the Montana Capital Corporations bill suggested by the Temporary Committee on Development Finance. The committee's bill would have provided a 50 percent tax credit, not a 25 percent credit. The committee's bill would have provided state funds to match the capitalization of the MCC's. In that sense, the committee's bill represented more of a joint public/private venture than does HB 685. Finally, the list of "qualified investments" in the committee's bill was couched in terms of business types excluded, not in terms of eligible businesses.

As I read through HB 685, I was surprised that all of the administraive functions were to be done by the Department of Commerce and not the Economic Development Board. Section 18 finally set me straight by pointing out that if the Board is created by HB 100, then the Board will be responsible, not the Department of Commerce.

We would like to make a suggestion to the committee regarding the Economic Development Board. General citizen representation will be essential to the success and fairness of the development finance programs. The composition of the Board is one place to ensure such representation. An additional possibility is to form several regional boards to advise the main Board. This would provide a more direct link between the diverse communities in Montana and the Board. This kind of grassroots involvement would strengthen the long-term ability of the Board to meet the economic development needs and desires of all Montanans.

The list of "qualified investments" (pp. 5-6, starting at line 4) is different than the approach suggested by the temporay committee. MEIC strongly supports "(ii) agricultural, fishery, or forestry production and processing;" "(iv) recognized nonfossil forms of energy generation as defined in 15-32-102(5);" "(vii) wholesale and retail distribution activities for which products produced in Montana comprise 50% or more of the gross sales receeipts;" and "(viii) any activity conducted in the state for which 50% or more of the gross receipts are derived from the sale of products or services outside Montana."

Finally, MEIC recommends that that the preferences in HB 100, as the select committee finally determines, be inserted in HB 385. The purpose is to carefully focus the program to maximize its ultimate economic effect. As we have pointed out earlier, this does not limit the program. Rather, it provides a preference when all other factors are equal.

SUBMITTED BY: Clint Grimes, 3/10/05, EXHIBIT NO. 13

(This sheet to be used by those testifying on a bill.)

NAME: Clint Grimes DATE: _____

ADDRESS: 7132 Canyon Ferry Rd. Helena, Mont

PHONE: 475-3668

REPRESENTING WHOM? Montana Consultants

APPEARING ON WHICH PROPOSAL: HB 685

DO YOU: SUPPORT? ✓ AMEND? _____ OPPOSE? _____

COMMENT:

Capitol Companies usually specialize in certain Industrial Sectors because of the high risk nature of investments. Montana has none of these specialized, high risk Capitol ~~Companies~~ Companies. An example is in the high tech area of the Bozeman area to beginning of a high Tech industry in Montana but no specialized investment facilities that understand the special risks and needs of these firms.

PLEASE LEAVE ANY PREPARED STATEMENTS WITH THE COMMITTEE SECRETARY.

Senator Lee made the motion that House Bill 100 As Amended Be Concurred In. Senator Goodover seconded the motion.

The Committee voted 9-1 with Senator Boylan voting no that HOUSE BILL 100 AS AMENDED BE CONCURRED IN.

Senator Towe will carry this bill on the floor.

ACTION ON HOUSE BILL 358: Senator Regan made the motion that House Bill 358 Be Concurred In. Senator Fuller seconded the motion.

The Committee voted, by Roll Call Vote, 8-2 with Senators Goodover and Severson voting no that HOUSE BILL 358 BE CONCURRED IN.

Senator Van Valkenburg will carry this bill on the floor.

ACTION ON HOUSE BILL 371: Senator Lee made the motion that House Bill 371 Be Concurred In. Senator Severson seconded the motion.

The Committee voted unanimously, by voice vote, that HOUSE BILL 371 BE CONCURRED IN.

Senator Towe will carry this bill on the floor.

ACTION ON HOUSE BILL 464: Senator Dover made the motion that House Bill 464 Be Concurred In. Senator Lee seconded the motion.

Senator Goodover made a substitute motion that House Bill 464 Be Not Concurred In. Senator Regan seconded the motion.

The Committee voted, by Roll Call Vote, 6-4, with Senators Dover, Fuller, Gage and Kolstad voting no that HOUSE BILL 464 BE NOT CONCURRED IN.

Senator Regan will carry this bill on the floor.

ACTION ON HOUSE BILL 685: Senator Fuller made the motion that on page 6, line 14, strike "March" and insert "January". Senator Lee seconded the motion.

The Committee voted unanimously, by voice vote, that the proposed amendment to HOUSE BILL 685 BE ADOPTED.

Senator Goodover made the motion that on page 4, line 2, following "businesses" strike remainder of line 2 through "are" on line 3 and on page 4, line 3, following "Montana" strike remainder of line 3 through "Montana" on line 4. Senator Lee seconded the motion.

The Committee voted unanimously, by voice vote, that the proposed amendments to HOUSE BILL 685 BE ADOPTED.

Senator Dover made the motion that on page 16, line 12, following "11" insert "and 16 and 17". Senator Fuller seconded the motion.

The Committee voted unanimously, by voice vote, that the proposed amend-

ment to HOUSE BILL 685 BE ADOPTED.

Senator Dover made the motion that House Bill 685 As Amended Be Concurred In. Senator Lee seconded the motion.

The Committee voted 9-1 with Senator Boylan voting no that HOUSE BILL 685 AS AMENDED BE CONCURRED IN.

Senator Van Valkenburg will carry this bill on the floor.

ACTION ON HOUSE BILL 700: Senator Dover made the motion that on page 31, line 14, following "accountability" strike remainder of line 14 through "Public" on line 16 and insert the previous language. Senator Lee seconded the motion.

The Committee voted 8-2 with Senators Fuller and Kolstad voting no that the proposed amendments to HOUSE BILL 700 BE ADOPTED.

Senator Dover made the motion that House Bill 700 As Amended Be Concurred In. Senator Christiaens seconded the motion.

The Committee voted 9-1 with Senator Boylan voting no that HOUSE BILL 700 AS AMENDED BE CONCURRED IN.

Senator Mazurek will carry this bill on the floor.

ACTION ON HOUSE BILL 818: Senator Goodover made the motion that House Bill 818 Be Concurred In. Senator Fuller seconded the motion.

The Committee voted, by Roll Call Vote, 5-5 so the motion failed. The bill will stay in committee.

ACTION ON HOUSE JOINT RESOLUTION 11: Senator Dover made the motion that House Joint Resolution 11 Be Not Concurred In. Senator Gage seconded the motion.

The Committee voted, by Roll Call Vote, 7-3 with Senators Christiaens, Fuller and Regan voting no that HOUSE JOINT RESOLUTION 11 BE NOT CONCURRED IN.

Senator Gage will carry this bill on the floor.

ADJOURN: There being no further business, the meeting was adjourned at 6:55 p.m.

Allen C. Kolstad

ALLEN C. KOLSTAD, CHAIRMAN

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STANDING COMMITTEE REPORT

March 22, 19 83

MR. PRESIDENT

We, your committee on BUSINESS AND INDUSTRY

having had under consideration HOUSE Bill No. 685

HARPER (VAN VALKENBURG)

Respectfully report as follows: That HOUSE Bill No. 685 be amended as follows:

1. Page 4, line 2.
Following: "businesses"
Strike: Remainder of line 2 through "ARE" on line 3.

2. Page 4, line 3.
Following: "Montana"
Strike: Remainder of line 3 through "Montana" on line 4.

3. Page 6, line 14.
Strike: "March"
Insert: "January"

4. Page 16, line 12.
Following: "11"
Insert: "and 16 and 17"

AND AS SO AMENDED,
BE CONCURRED IN

ALLEN C. KOLSTAD, Chairman.

STATE PUB. CO.
Helena, Mont.

MC